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No. OFFICE OF THE CLERK

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Supreme Court of the United States

COLORADO OFFICE OF CONSUMER COUNSEL,
RHODE ISLAND ATTORNEY GENERAL,
NEW MEXICO ATTORNEY GENERAL,
PUBLIC UTILITY LAW PROJECT OF NEW YORK, INC.,
AND NATIONAL CONSUMER LAW CENTER, INC.,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

On Petition for a Writ of Certiorari to the
United States Court of Appeals for the D.C. Circuit

SUPPLEMENTAL APPENDIX TO PETITION

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105 FERC ¶ 61,218
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman; William L. Massey, and Nora Mead Brownell.

Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations

Docket Nos. EL01-118-000 and EL01-118-001

ORDER AMENDING MARKET-BASED RATE TARIFFS AND AUTHORIZATIONS

(Issued November 17, 2003)

1. In an order dated June 26, 2003, the Commission, acting pursuant to Section 206 of the Federal Power Act (FPA),[1] proposed to condition all new and existing market-based rate tariffs and authorizations on sellers' compliance with six proposed Market Behavior Rules.[2] The need for these Market Behavior Rules, we stated, was informed by the types of behavior that had been observed in the Western markets during 2000 and 2001; by Commission Staff's Final Report

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[1] 16 U.S.C. § 824e (2000).

[2] See Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 103 FERC ¶ 61,349 (2003) (June 26 Order). These Market Behavior Rules address: (i) unit operations; (ii) market manipulation; (iii) communications; (iv) reporting; (v) record retention; and (vi) related tariff matters.

concerning these markets (Western Markets Report);[3] by our experience in other markets, including the organized spot markets in the East; and by the comments filed in response to our initial proposal in this proceeding.[4]

2. In the June 26 Order, we also stated that in formulating our proposed Market Behavior Rules, we were required to strike a careful balance among a number of competing interests. We noted, for example, that while market participants must be given an effective remedy in the event anticompetitive behavior or other market abuses occur, sellers should be provided "rules of the road" that are clearly-delineated. We noted that while regulatory certainty was important for individual market participants and the marketplace in general, the Commission must not be im-

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[3] Final Report on Price Manipulation in Western Markets: Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, Docket No. PA02-2-000 (March 2003).

[4] In an order issued in this proceeding on November 20, 2001, we proposed to condition all new and existing market-based rate tariffs and authorizations to include a broad prohibition against "anticompetitive behavior" and the "exercise of market power." See Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 97 FERC ¶ 61,220 (2001) (Initial Order). Numerous responsive pleadings were filed in which it was asserted, among other things, that the Commission's proposed tariff provision was vague and overbroad, and that without greater specificity and guidance, our proposed tariff provision would create uncertainty in the marketplace. In the June 26 Order, we noted that our revised proposal was designed to identify more precisely and comprehensively than we had in our Initial Order the transactions and practices that would be prohibited under sellers' market-based rate tariffs and authorizations. See June 26 Order, 103 FERC ¶ 61,349 at P6.

paired in its ability to provide remedies for market abuses whose precise form and nature cannot be envisioned today. We sought comments on whether our proposed rules achieved the appropriate balance among these competing interests.[5]

3. The vast majority of the comments we received in response supported the Commission's overall objectives in this proceeding, i.e., the need to establish clear guidelines applicable to market-based rate sellers' conduct in the wholesale markets. In addition, we received a number of constructive suggestions for fine-tuning the specific language embodied in our proposed rules. Based on these comments and based on our further consideration of the issues discussed below, we find that sellers' existing tariffs and authorizations, without clearly-delineated rules of the road to govern market participant conduct, are unjust and unreasonable. Without such behavioral prohibitions, the Commission will not be able to ensure that rates are the product of competitive forces and thus will remain within a zone of reasonableness. We further find that our Market Behavior Rules, as modified in Appendix A to this order, are just and reasonable and will help ensure that rates are the product of competitive forces and thus remain just and reasonable.

Background

4. In the June 26 Order, we noted that as part of our ongoing responsibility to provide regulatory safeguards to ensure that customers are protected from market abuses, we were required to balance the fol-

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[5] June 26 Order, 103 FERC ¶ 61,349 at P7.

lowing three goals: first, the need to provide for effective remedies on behalf of customers in the event anticompetitive behavior or other market abuses occur; second, the need to provide clearly-delineated "rules of the road" to market-based rate sellers while, at the same time, not impairing the Commission's ability to provide remedies for market abuses whose precise form and nature cannot be envisioned today; and third, the need to provide reasonable bounds within which conditions on market conduct will be implemented so as not to create unlimited regulatory uncertainty for individual market participants or harm to the marketplace in general. We also noted that a stable marketplace with clearly defined rules would benefit both customers and market participants and would create an environment that will attract much-needed capital.[6]

5. Based on these objectives, we proposed six specific Market Behavior Rules to govern sellers' conduct in the wholesale market:

- Unit Operation: We proposed that sellers be required to operate and schedule generating facilities, undertake maintenance, declare outages, and commit or otherwise bid supply in a manner that complies with the rules and regulations of the applicable power market;
- Market Manipulation: We proposed to prohibit all forms of market manipulation ;
- Communications: We proposed to require that sellers provide complete, accurate and factual information and not submit false or misleading

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[6] June 26 Order, 103 FERC ¶ 61,349 at P5.

information, or omit material information, in any communication with the Commission, market monitors, regional transmission organizations (RTOs), independent system operators (ISOs), or similar entities;

- Reporting: We proposed to apply this same standard with respect to reports made by sellers to publishers of electricity or natural gas price indices;
- Record Retention: We proposed to require sellers to retain for a period of three years all data and information necessary for the reconstruction of the prices they charge, and the prices they report for use in published price indices;
- Related Tariffs: Finally, we proposed to clarify that sellers would not be permitted to violate or collude with another party in actions that violate seller's code of conduct or Order No. 889 standards of conduct.

6. We also stated that any seller found to have engaged in the behavior prohibited by our rules would be subject to a disgorgement remedy and any other appropriate non-monetary remedies such as revocation of seller's market-based rate authority. We sought comments from interested entities concerning a number of issues, including the specific language embodied in the rules themselves, the overall balance of interests reflected in these rules, and the remedies and procedures that would be available to market participants with respect to their enforcement.[7]

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[7] In a companion issuance, we also proposed to modify natural gas market blanket certificates under subpart G of Part 284

(*Footnote continued*)

Notice and Responsive Pleadings

7. The June 26 Order was published in the Federal Register.[8] Interested entities were invited to file comments within 30 days of this date, with reply comments permitted within 30 days of the comment submission date. In response, numerous comments and reply comments were received from entities representing federal and state agencies, consumer advocates, trade organizations, and all segments of the industry. These entities are listed in Appendix C to this order.

8. Comments generally supportive of the Commission's proposed rules were submitted by a broad majority of the entities who filed comments. Specifically, commenters generally concurred that establishing a clear set of market behavior standards governing sellers' conduct in the wholesale markets is necessary. There were disagreements voiced over the means to meet these objectives. For example, some argued that our proposed rules were a necessary but not a sufficient step forward in addressing the concerns outlined in the June 26 Order. These commenters submitted that in addition to our proposed rules, we should also consider a number of market design changes to bolster the overall competitiveness of the wholesale markets. Others (most notably sellers or entities representing their interests) asserted that our proposed

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of the Commission's regulations to contain many of the standards proposed herein, where applicable. See Notice of Proposed Rulemaking, Docket No. RM03-10-000, Amendments to Blanket Sales Certificates, 103 FERC ¶ 61,350 (2003). A Final Rule in that proceeding is being issued contemporaneously with this order.

[8] 68 Fed. Reg. 40,924 (2003).

rules would, if implemented, impose a heavy-handed, open-ended burden on sellers that would, without fine-tuning and clarification, chill investment in the industry. A number of revisions were proposed addressing these issues.

9. On July 28, 2003, Southern Company Services, Inc. (Southern) filed a request for rehearing of the June 26 Order concerning the Commission's asserted statutory authority to adopt its proposed rules.

Discussion

Procedural Matters

10. We will grant intervention status to each of the entities listed in Appendix C to this order. In addition, we will dismiss Southern's request for rehearing. As we held in the June 26 Order and reiterate here, rehearing may not be sought in this case until such time as the Commission issues a final order, i.e., within 30 days of the issuance of this order.[9] However, we will treat Southern's rehearing request as a comment, the substance of which is addressed in Section N, below.

Analysis

11. The task before us in this proceeding is to determine how and to what extent market-based rate seller conduct in the wholesale markets should be monitored by the Commission and, when necessary, how and to what extent this conduct should be remedied. To this end, we concur with the consensus view conveyed in the comments we have received in response to our proposed rules, namely, that sellers, while ac-

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[9] See Rule 713 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.713 (2003).

countable for their actions, need and deserve clearly-delineated rules governing their conduct so that both sellers, buyers, and other interested entities will know what is and what is not acceptable market behavior. We find market-based rate tariffs and authorizations that do not include such standards are unjust and unreasonable.

12. Our behavioral rules are designed to provide market participants adequate opportunity to detect, and the Commission to remedy, market abuses. Our behavioral rules are also clearly defined so that they do not create uncertainty, disrupt competitive commodity markets or simply prove ineffective. However, since competive markets are dynamic, it is important that we periodically evaluate the impact these rules have on the energy markets. We direct our office of Market Oversight and Investigation to evaluate the effectiveness and consequences of these behavioral rules on an annual basis and include this analysis in the State of the Markets Report.

A. Market Behavior Rule 1 (Unit Operation)

1. Commission Proposal

13. In the June 26 Order, we noted that the integrity of an organized market and other markets as well require sellers to comply with the rules and regulations of the applicable power market. In Market Behavior Rule 1, therefore, we proposed to require that sellers operate and schedule generating facilities, undertake maintenance, declare outages, and commit or otherwise bid supply in a manner that complies with these rules and regulations. We stated that while market participants may become subject to additional requirements through tariff service agreements or other market participation agreements, a specific require-

ment in each seller's market-based rate tariff addressing unit operation issues would be necessary in order to give the Commission and interested parties direct remedial authority for violations that may not exist without such a condition.

2. Comments

14. Commenters argue that Market Behavior Rule 1, unless it is revised, could be relied upon by market operators to impose operating and maintenance standards that would require generators to violate permit restrictions or operate in an unsafe manner.[10] EPSA, et al. request that the rule be modified by adding that the unit operation requirement contemplated by the rule be "consistent with the operational, legal and economic constraints on such generating facilities."[11] The New York Independent System Operator, Inc. (New York ISO) characterizes this issue as a reliability concern, and proposes that the rule require sellers to inform the system operator if they are unable to follow the dispatch instructions they receive. The New York ISO also proposes that Market Behavior Rule 1 be modified to require sellers to use their "best efforts

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[10] Comments of Electric Power Supply Association, Colorado Independent Energy Association, Independent Energy Producers of California, Independent Power Producers of New York, Inc. and the Western Power Trading Forum (EPSA, et al.) at 2. See also Comments of Exelon Corporation (Exelon) at 6; Comments of Reliant Energy Power Generation, Inc. and Reliant Energy Services, Inc. (Reliant) ("Generators should not be penalized for failure to operate a plant in a physically impossible manner or in a way that is inconsistent with economic and environmental restrictions").

[11] See also Comments of Reliant at 4; Comments of Edison Electric Institute (EEI) at 8.

to comply with the operating instructions of the applicable power system operator."

15. Commenters also assert that the "rules and regulations" to which the proposed rule refers should be limited to "Commission-approved" rules and regulations.[12] FirstEnergy asserts that absent this limitation, the rules of the applicable power market, as referenced by the proposed rule, may be unknowable and uncertain and thus, among other things, lack the procedural safeguards triggered by a Section 205 filing. Dynegy explains that ISOs, RTOs and transmission providers occasionally adopt rules, protocols, or guidelines (or interpretations of tariff provisions) without vetting them through the stakeholder process and without Commission authorization.

16. Pacific Gas and Electric Company (PG&E) submits that the term "applicable power market" also requires clarification, where there is more than one market and more than one set of rules which may apply. In addition, commenters take varying positions on the issue of whether the Commission's proposed prohibitions should apply to bilateral and forward markets.[13] APPA and TAPS argue that they should, while EPSA, et al., EEI, Southern, and others assert that Market Behavior Rule 1 is inapplicable as it re-

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[12] See, e.g., Comments of EEI at 8; Comments of FirstEnergy Service Company (FirstEnergy) at 6; Comments of Duke Energy Corporation (Duke) at 36; Comments of Dynegy Power Marketing, Inc., et al. (Dynegy) at 5; Comments of Edison Mission Energy at 5-6; Comments of Pinnacle West Companies (Pinnacle) at 5.

[13] Commenters make similar arguments as they relate to proposed Market Behavior Rule 2, discussed below.

lates to these markets.[14] Southern, for example, asserts that the market abuse concerns of the type contemplated by the proposed rule do not arise in the context of arm's-length negotiations. On this same basis, EPSA, et al. request clarification that Market Behavior Rule 1 (and indeed each of the Commission's proposed rules) will not be a basis for modifying rates otherwise agreed to by such parties.

17. Merrill Lynch Capital Services, Inc. and Morgan Stanley Capital Group Inc. (Merrrill Lynch, et al.) request clarification that Market Behavior Rule 1 will not apply to marketers that do not own generation. Merrill Lynch, et al. also argue that scheduling services should not, by itself, be considered sufficient to constitute "control" of generation. Finally, the Colorado Office of Consumer Counsel[15] (Colorado Consumer Counsel, et al.) interprets Market Behavior Rule 1 as a prohibition against capacity withholding and seeks clarification regarding the application of such a rule to hydroelectric generation in those parts of the country where hydro power is used primarily for peak shaving.

3. Commission Ruling

18. We will approve Market Behavior Rule 1, subject to two revisions, as requested. First, we will revise the rule to clarify that the "rules and regulations" to which the rule refers apply only to "Commission-

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[14] See, e.g., Comments of Exelon at 5; Reply Comments of Central Maine, et al. at 3.

[15] Joined by the New Mexico Attorney General, the Rhode Island Attorney General, the Utah Committee of Consumer Service, the Public Utility Law Project of New York, Inc., the National Consumer Law Center, and Public Citizen, Inc.

approved" rules and regulations. Second, we will revise the rule to clarify that the operation of this rule will not impose a must-offer requirement on sellers (although sellers may have such an obligation independent of this rule). As revised, Market Behavior Rule 1 will require market-based rates sellers to:

> *Operate and schedule generating facilities, undertake maintenance, declare outages, and commit or otherwise bid supply in a manner that complies with the Commission-approved rules and regulations of the applicable power market. Compliance with this Market Behavior Rule 1 does not require Seller to bid or supply electric energy or other electricity products unless such requirement is a part of a separate Commission-approved tariff or requirement applicable to Seller.*

19. As we noted in the June 26 Order, Market Behavior Rule 1 will aid the Commission in ensuring that the rates, terms and conditions charged by market-based rate sellers remain just and reasonable by tying sellers' conduct with respect to their unit operations to the rules and regulations of the power markets in which they do business. Our rule will thus give the Commission direct remedial authority for violations that may not exist in certain cases absent such a rule.

20. Commenters assert and we agree, however, that the rules and regulations to which this rule refers should be limited to "Commission-approved" rules and regulations of the applicable power market. We agree that it would not be appropriate to require that a market-based rate seller be made subject to potential sanction for rules or regulations (e.g., technical guidelines set forth in protocols) that have not been

filed with the Commission. We also clarify that Market Behavior Rule 1, while requiring compliance with any Commission-approved rule or regulation of the applicable power market, will not otherwise apply to any bilateral power sales arrangement or other transactions to which the seller may be a party.

21. We will also revise Market Behavior Rule 1 to make clear that no "must offer" requirement will be imposed under this rule. As revised, the rule makes clear that "[c]ompliance with this Market Behavior Rule 1 does not require Seller to bid or supply electric energy or other electricity products unless such requirement is a part of a separate Commission-approved tariff or requirement applicable to Seller." Unless the seller is subject to a must-offer requirement pursuant to the applicability of a Commission-approved tariff, or other specific Commission-approved obligation, then, the seller will not be subject to such a requirement under our rule.[16] We also clarify that our rule is not intended to supersede market-specific rules such as those for outage scheduling/reporting and bidding that we have approved in our acceptance of ISO/RTO tariffs. In sum, we clarify that this rule is not intended to serve as an independ-

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[16] To make this same point, as discussed in Section G, below, we are also rejecting our proposed Market Behavior Rule 2(e). That proposed rule, which addressed market manipulation in a specific context (i.e., with respect to "bidding the output of or misrepresenting the operational capabilities of generation facilities in a manner which raises market prices by withholding available supply from the market") was incorrectly interpreted by commenters as a must-offer requirement.

ent basis to impose any new obligations on sellers, or to further regulate bilateral markets.[17]

22. We will reject commenters' proposed clarification that our rule apply only to market-based rate sellers who own physical generation assets. Sellers, whether they do or do not own generation, participate in markets, bid supply, and, in many cases, control generation resources through contract rights. We also clarify that to the degree physical withholding or economic withholding issues are the subject of an applicable power market's rules and regulations, sellers' compliance with such rules and regulations will satisfy the seller's obligations. Thus, unless concepts of physical or economic withholding are a component of a broader manipulative behavior, as addressed in Market Behavior Rule 2, discussed below, actions taken in accord with the Commission-approved rules of an applicable power market will not be considered actionable physical or economic withholding.

23. Finally, commenters raise concerns that Market Behavior Rule 1 could require unit operation in an unsafe manner or in a way that could violate environmental permit restrictions. However, we are not aware of any Commission-approved rule or regulation (and commenters cite to no rule or regulation) which would require sellers to operate their units in an unsafe manner or in violation of any environmental permit restrictions. Issues of this nature should be raised and addressed in the applicable power markets when and to the extent they may arise.

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[17] Additional issues relating to RTO/ISO coordination matters are discussed in Section O, below.

B. Market Behavior Rule 2 (Market Manipulation)

1. Commission Proposal

24. In the June 26 Order, we stated that our reliance on competitive markets to establish just and reasonable rates requires that we have the tools necessary to ensure that prices created in these markets continue to fall within a just and reasonable zone. We stated that the tools we have relied upon include non-discriminatory transmission access, an efficient and pro-competitive wholesale market platform, and effective market monitoring and enforcement. Accordingly, we proposed to prohibit activities that adversely affect competitive outcomes, by stating that "[a]ctions or transactions without a legitimate business purpose which manipulate or attempt to manipulate market prices for electric energy and/or electric energy products which do not reflect the legitimate forces of supply and demand, are prohibited."[18]

2. Comments

25. The Electricity Consumers Resource Council[19] (ELCON, et al.) support Market Behavior Rule 2, as proposed. ELCON, et al. assert that the Commission's proposed anti-manipulation prohibition is necessary due to the absence of and/or weakness of such provi-

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[18] June 26 Order, 103 FERC ¶ 61,349 at P22.

[19] Joined by the American Iron and Steel Institute, the American Chemistry Counsel, the American Forest & Paper Association, the Association of Business Advocating Tariff Equity, California Large Energy Consumers Association, Connecticut Industrial Energy Consumers, Industrial Energy Consumers of Pennsylvania, Southeast Electricity Consumers Association, and Multiple Intervenors.

sions in the markets operated by the Cal ISO, PJM, ISO New England, Inc., the New York ISO and the Midwest Independent System Operator, Inc. (Midwest ISO). ELCON, et al. characterize the anti-gaming provisions currently in effect in these markets as vague and conflicting, while in other regions of the country there are no standards at all. ELCON, et al. conclude that the Commission's proposal to apply a single anti-gaming prohibition applicable to all markets is appropriate and urgently needed.

26. Other commenters take issue with the market manipulation prohibition set forth in proposed Market Behavior Rule 2. First, commenters assert that a market manipulation prohibition should not be applied to bilateral markets. Mirant and TransAlta, for example, argue that there is no economic rationale for applying market manipulation rules outside the short-term spot markets for power, given the difficulty of exercising market power in forward markets directly or leveraging market power from short-term markets into the forward markets. APPA and TAPS take the opposite position, noting market power and manipulation risks arise not only in the spot markets, but in the bilateral markets as well.

27. Commenters also challenge the sufficiency of the term "legitimate business purpose" in distinguishing between prohibited and non-prohibited conduct and question whether and to what extent the Commission can fairly (and with adequate notice to sellers) identify such motives. InterGen North America, L.P. (InterGen) argues, therefore, that the term "legitimate business purpose" is fatally vague and that there are no recognized principles or accepted rules or standards in the industry that would assist market participants in understanding what is and what is not "le-

gitimate." InterGen notes, in this regard, that Webster's Disctionary defines the word "legitimate" as conforming to recognized principles or accepted rules and standards.[20] Dynegy Power Marketing, Inc. (Dynegy) asserts that in the organized markets in the East, any bid with respect to the marginal unit could be accused of attempting to manipulate prices, even if the market is covered by mitigation procedures that limit the unit's bidding parameters.

28. For others, the term "legitimate business purpose" is insufficient because it will allow sellers who should be sanctioned to justify their bad conduct. The National Association of State Utility Consumer Advocates (NASUCA) points out that this term, if approved, will invite market participants to try to excuse actions that are manipulative but that were undertaken to promote some imaginable business purpose.

29. Other commenters focus their concerns on the term "legitimate forces of supply and demand." EPSA, et al. suggest that there is little consensus as to what price might result from the unfettered interplay among these market forces because there is little consensus as to how to value scarcity, how supply and demand interact to set prices, when to allow reserves and/or demand response to set the market clearing prices, what the proper components of marginal cost are, and when mitigation is appropriate. EPSA, et al. assert that without a clearer consensus on the proper

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[20] See also Comments of EEI at 10 (asserting that the term "legitimate business purpose" is vague and would, if adopted, create market uncertainty); Reply Comments of Mirant and TransAlta at 16.

approach to price formation, the proposed term will result in a great deal of controversy and expensive litigation to address issues that would be better resolved in other forums. In addition, EPSA, et al. submit that any attempt to reconstruct the legitimate forces of supply and demand in a complex market in which the interaction of the parties affects the outcome is virtually impossible.

30. Numerous commenters also argue that as a means of limiting the proposed rule and better defining it, an intent standard must be adopted (a recommendation also made with respect to certain other Market Behavior Rules, as discussed below).[21] EME argues that without intent to manipulate the proposed rule, it would be unfair to punish market participants for actions that are economically justifiable and within the bounds of these rules are properly undertaken to maximize returns in a competitive market. Southern adds that to address these concerns, Market Behavior Rule 2 should be modified to prohibit sellers from "knowingly" engaging in the conduct prohibited by the rule "with the intent" to manipulate market prices, with a "showing that the seller actually succeeded in its efforts to manipulate the market."[22]

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[21] See, e.g., Comments of EEI at 10; Comments of EPSA, et al. at 8-12; Comments of Exelon at 6; Comments of Southern at 12; Comments of Edison Mission Energy (EME) at 6; Comments of Pinnacle West at 6; and Comments of Reliant at 6.

[22] Other commenters propose similar language incorporating this element of intent. See, e.g., Comments of EPSA, et al. (prohibiting actions or transactions without a legitimate purpose "and which are intended to" manipulate or attempt to manipulate market prices); Comments of Reliant at 6 (prohibiting actions or transactions "undertaken" without a legitimate business purpose "and intentionally to" manipulate market prices).

31. Reliant also argues that the term "electric energy products," as used in the proposed rule, is undefined and otherwise unnecessary. Reliant notes the proposed rule already prohibits manipulation of market prices and that this prohibition covers prices associated with any jurisdictional product, whether energy, ancillary services, transmission, or any other.

32. The New York State Public Service Commission (New York Commission) requests that the Commission clarify that sellers are bound by the actions or transactions of their affiliates, as they relate to this rule. The New York Commission states that absent this clarification, sellers would be permitted to sidestep this rule by way of affiliate gaming practices. The New York Commission concludes that if a seller's affiliate violates a Market Behavior Rule in a way that improperly raises market prices and the seller enters into long-term contracts that benefit from that price, the seller's contract should be governed by this rule just as if the contracts had been signed by the affiliate.

33. Commenters also express concerns regarding the general impact of the proposed rule on the marketplace as a whole. EPSA, et al. claim that without greater specificity and clarity, the proposed rule will lead to excessive litigation. EEI speculates that sellers engaging in proscribed transactions will rely on the ambiguity in the proposed rule to defend their bad conduct. East Texas Cooperatives and First Energy suggest that the over-breadth of the proposed rule will prohibit or at least chill legitimate business behavior. The New York ISO submits that with the uncertainty engendered by the proposed rule, higher market prices may be necessary to induce construction of new generation in New York and in other regions.

34. Finally, the Federal Trade Commission (FTC) argues that structurally competitive markets that foster ease of entry are critical to efficient pricing, output, and investment, and are more likely to protect consumers than would the proposed rule. The FTC also suggests that because there may be conflicts between antitrust law and the meaning of the terms used by the Commission in the proposed rule (e.g., the term "without a legitimate business purpose"), the Commission should limit and better focus its rule such that it would only prohibit sellers from engaging in conduct that violates the antitrust laws.

3. Commission Ruling

35. We will adopt the prohibition against market manipulation, as set forth in Market Behavior Rule 2, as revised. As revised, the rule provides:

> *Actions or transactions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electricity products are prohibited. Actions or transactions undertaken by Seller that are explicitly contemplated in Commission-approved rules and regulations of an applicable power market (such as virtual supply or load bidding) or taken at the direction of an ISO or RTO are not in violation of this Market Behavior Rule.*

36. Our rule, as revised, balances the need to provide sellers clearly-defined rules of the road while, at the same time, not impairing the Commission's ability to provide remedies for market abuses whose precise form and nature cannot be envisioned today. This objective is satisfied, here, by our reliance on a prohibi-

tion that is broad enough in its reach and yet clear enough in its focus to capture manipulative conduct in all its forms. Our rule, in essence, is designed to prohibit market-based rate sellers from taking actions which interfere with the prices that would otherwise be set by competitive forces, or from manipulating market conditions or market rules.[23] This standard, which recognizes that manipulative actions engaged in by sellers are not undertaken for a legitimate business purpose, has been applied by the Commission in the past.[24] For the reasons discussed herein, we apply it now to all market-based rate sellers.

37. In doing so, we clarify that transactions with economic substance, in which a seller offers or provides service to a willing buyer and where value is exchanged for value, are not prohibited by our rule. While commenters question the usefulness of the term "legitimate business purpose," in this context, we note that our reliance on this measure will ensure that sellers acting in a pro-competitive manner will have the opportunity to show that their actions were not designed to distort prices or otherwise manipulate the market. Behaviors and transactions with economic substance will thus be recognized as reflecting

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[23] An example of sellers' ability to manipulate market conditions is discussed in Section C, below, relating to wash trades. An example of sellers' ability to manipulate market rules is discussed in Section D (submission of false information) and Section E (creation of artificial congestion). An example of seller's ability to manipulate market prices is discussed in Section F (collusive acts).

[24] See Enron Power Marketing, Inc., 103 FERC ¶ 61,343 (2003) (Enron) (revoking Enron's blanket marketing certificate authorization based on Enron's participation in wash trades having "no legitimate business purpose").

a legitimate business purpose consistent with just and reasonable rates.

38. However, an action or transaction which is anti-competitive (even though it may be undertaken to maximize seller's profits), could not have a legitimate business purpose attributed to it under our rule. If, for example, a seller is shown to have caused, or attempts to cause, an artificial shortage by physically withholding sufficient and otherwise available power from the market for the purpose of raising the sales price obtainable by other units participating in the market – the seller may be found to have engaged in market manipulation, as prescribed by Market Behavior Rule 2, i.e., under these circumstances, there can be no legitimate business purpose attributable to such behavior.[25]

39. Our prohibition against market manipulation is not the only tool we intend to rely upon to ensure competitive markets.[26] It is, however, a necessary tool, because it reflects the reality that we oversee a dynamic and evolving market where addressing yesterday's concerns may not address tomorrow's. As we apply

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[25] The available supply, in this instance, would have been withheld from the market without a legitimate business purpose with the objective of distorting the price of the remaining supply. Conversely, if the power was withheld due to a forced or planned outage, environmental restrictions, labor disruption, or similar business purpose, the resulting transaction would be reflective of a competitively derived price and would not be found to be manipulative. In this regard, we reject NASUCA's concern, i.e., that sellers can fabricate legitimate business purposes where there are none. In fact, the Commission is well equipped, on a case-by-case basis, to determine whether the motives ascribed to transactions by sellers are legitimate or not legitimate.

[26] See infra Section L.

Market Behavior Rule 2, moreover, we will be mindful of the fact that we are not only taking steps to assure just and reasonable rates for a specific transaction but are also providing guidance to sellers in general. As such, in determining the appropriate remedy for violations of this rule, we will take into account factors such as how self evident the violation is and whether such violation is part of a pattern of manipulative behavior.

40. As recommended by commenters, we will strike from our prohibition the proposed term that would have characterized, as manipulative behavior, an act resulting in "market prices which do not reflect the legitimate forces of supply and demand." While we do not believe that our use of this term was inappropriate or unjustified (as we intended it), many commenters appear to have misunderstood its purpose, suggesting that other causes (e.g, the lack of elasticity of demand in an organized market) may explain a given dysfunction in the interplay between supply and demand. To avoid confusion on this point, then, and because our objectives with respect to this rule can be satisfied under the surviving clause, discussed above, we have eliminated this term from our rule. We clarify, then, that our rule is not meant to say that we will identify prices that properly reflect supply and demand and then take action against sellers whose prices (however they may be established) differ. Rather, our rule is designed to prohibit market-based rate sellers from taking actions without a legitimate business purpose which intend to or foreseeably

could interfere with the prices that would be set by competitive forces.[27]

41. We will reject commenters' argument that Market Behavior Rule 2 should identify and prohibit only expressly-defined acts of manipulation. For all the reasons discussed above, it is essential and appropriate that we have a prohibition designed to prohibit all forms of manipulative conduct. In approving such a prohibition, moreover, we take the necessary safeguards, both procedural and substantive. Thus, in the event the Commission receives a complaint about a particular behavior or identifies such behavior on its own, we will inquire into all of the surrounding facts and circumstances to understand the purpose for which the behavior was undertaken and the intended or foreseeable outcome of the behavior.

42. As a threshold matter, the Commission will evaluate if the facts presented appear to warrant further inquiry into whether the transaction appears to be of a questionable purpose. For example, actions or transactions undertaken at the direction of an ISO or an RTO are not, by definition, market manipulation in violation of our rule. In determining whether an activity is in violation of our rule, we will evaluate whether the activity was designed to lead to (or could foreseeably lead to) a distorted price not reflective of a competitive market.[28] If, thereafter, the market-based rate

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[27] The rule, then, covers actions that are intended to manipulate prices regardless of whether these actions actually accomplish their purpose. We note, however, that in most such cases, there will be no unjust profits to disgorge.

[28] When deciding how best to allocate our enforcement resources, we intend to focus our efforts primarily on those ac-

(*Footnote continued*)

seller can establish that the behavior at issue was undertaken to provide service to a buyer with rates, terms, and conditions disciplined by the competitive forces of the market, we would find the transaction to have a legitimate business purpose and its rates to reflect a just and reasonable competitive level.

43. Our approach to the enforcement of our rules, then, will be based on a consideration of the facts and circumstances of the conduct at issue to determine its purpose and intended or foreseeable result. We recognize that manipulation of energy markets does not happen by accident. However, we also recognize that intent often must be inferred from the facts and circumstances presented. Therefore, a violation of Market Behavior Rule 2 must involve conduct which is intended to, or could foreseeably result in, distorted prices.

44. While we believe that this approach to identifying and remedying market manipulation is necessary, we also believe it is fair. We believe, for example, that sellers can recognize the difference between actions and strategies that are in furtherance of legitimate profit opportunities, or which serve important market functions, and those that result in prices that would not have been bid or paid in the absence of manipulation. We expect our enforcement and complaint procedures, as approved herein, will allow us to timely examine and fairly determine, on a case-by-case basis, when, and if, a strategy employed by a seller lacks a legitimate business purpose.

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tions or transactions that have, in fact, caused distorted market prices.

45. Moreover, while our rules will apply to all jurisdictional markets, we note these rules will not supersede or replace parties' rights under Section 206 of the FPA to file a complaint contending that a contract should be revised by the Commission (pursuant to either the "just and reasonable" or "public interest" tests as required by the contract). Rather, any party seeking contract reformation or abrogation based on a violation of one or more of the Market Behavior Rules adopted herein would be required to demonstrate that such a violation had a direct nexus to contract formation and tainted contract formation itself. If a jurisdictional seller enters into a contract without engaging in behavior that violates its tariff with respect to the formation of such contract, we do not intend to entertain contract abrogation complaints predicated on our Market Behavior Rules.

C. Market Behavior Rule 2(a) (Prohibition Against Wash Trades)

1. Commission Proposal

46. In addition to the prohibition against market manipulation set forth in proposed Market Behavior Rule 2, we also proposed to prohibit wash trades as a specific transaction that would be prohibited under our proposed rule, i.e., "pre-arranged offsetting trades of the same product among the same parties, which trades involve no economic risk, and no net change in beneficial ownership."

2. Comments

47. The New York ISO suggests that as an alternative to this express prohibition, the Commission should rely on the ISO (or RTO) market monitoring unit to craft and implement rules specifically tailored to ad-

dress improper conduct if and as it arises.[29] The New York ISO also states that even if this express prohibition is adopted, the relevant aspects of the proposed rule should be incorporated into the reporting requirement embodied in Market Behavior Rule 4 (discussed below).

48. NASUCA asserts that the proposed definition of "wash trade" is too narrow, allowing sellers to evade regulation by slightly altering their transactions as they relate to price or quantity. The California Electricity Oversight Board (Cal Oversight Board) agrees, noting that by contrast, the Commodity Exchange Act defines wash trades as transactions producing "a virtual financial nullity because the resulting net financial position is near or equal to zero."[30] The Cal Oversight Board further asserts that if the Commission's wash trade prohibition is limited to the "same parties," as proposed, the Commission would be unable to sanction transactions entered into between independent or affiliated third parties.

49. Northeast Utilities argues that the proposed rule is too broad, prohibiting sellers from engaging in legitimate "sleeve" transactions and other legitimate transactions. EEI also asserts that the proposed rule could be applied to legitimate transactions in an unfair and unjustified way. EEI states, for example, that market participants sometimes engage in product swaps between different locations to avoid the need to use physical transmission and that these transactions are

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[29] As discussed below, the New York ISO makes the same suggestion as it relates to Market Behavior Rules 2(b) and 2(c).

[30] Comments of the Cal Oversight Board at 10-11, citing 7 U.S.C. § 6c (2000) (emphasis added).

both useful and legitimate.[31] To exempt such transactions from the prohibitions contemplated by Market Behavior Rule 2(a), therefore, EEI suggests that the qualifying language "at the same location" be added after the phrase "pre-arranged, simultaneous, offsetting trades of the same service or product among the same parties." In addition, Duke Energy requests clarification that "bookout" transactions, in which companies with offsetting delivery obligations resulting from heavy trading activity agree not to deliver to one another the offsetting amounts of energy, not be regarded as a prohibited wash trade.[32]

50. The New York ISO also identifies a transaction which it claims should not fall within the Market Behavior Rule 2(a) prohibition. The New York ISO states that when a market participant mistakenly buys instead of sells, or accidentally buys more energy or capacity than it needs, it may be required to close out of this erroneous position as quickly as possible. The New York ISO states that to do so, the market participant may wish to enter into an offsetting transaction, possibly with the same party or on the same trading platform. Such a transaction, the New York ISO contends, is legitimate and should not be prohibited.

51. To clarify what would and what would not constitute a prohibited wash trade, Merrill Lynch, et al. propose that the rule specify what they claim are the three necessary elements of a "wash trade:" (i) a deliberately pre-arranged "pair" of trades; (ii) made at the same time, for the identical price, and at the same delivery point; (iii) between the same legal entities.

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[31] See also Comments of Dynegy at 8.

[32] See also Comments of Ontario Power Generation Inc. at 4.

Reliant proposes that Market Behavior Rule 2(a) be modified to encompass "trades of the same product among the same parties, which trades are pre-arranged to be offsetting and involve no economic risk and no net change in beneficial ownership." Finally, for the same reason as noted above, commenters propose that an intent standard be adopted as it relates to Marker Behavior Rule 2(a).[33]

3. Commission Ruling

52. We will adopt Market Behavior Rule 2(a), as proposed, to address, as a prohibited action or transaction:

> *Pre-arranged offsetting trades of the same product among the same parties, which involve no economic risk and no net change in beneficial ownership (sometimes called "wash trades").*

53. As described in the Western Markets Report, market participants engaged in wash trading during the period 2000-01 and, as a result, distorted market liquidity as well as other indicators of market performance.[34] As we have noted before and reiterate here, such activity should be considered a serious violation of the authority to sell power at market-based rates. Market Behavior Rule 2(a), therefore, expressly prohibits this activity by identifying the two key elements of a wash trade, i.e., transactions which are (i) pre-arranged to cancel each other out; and (ii) involve no economic risk.

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[33] See, e.g., Comments of EPSA, et al. at Att. B, p. 3; Comments of EEI at 13; Comments of Pinnacle West at 7; Merrill Lynch, et al. at 8; Comments of Duke Energy at 36; Reply Comments of ANP, et al. at 3.

[34] Western Markets Report at VI-1.

54. EEI requests clarification that an exchange of power undertaken to avoid the procurement of a transmission service would not be considered a wash trade under our rule. We will grant EEI's request for clarification. As we understand the issue raised by EEI, the subject transactions would either be at different prices, transfer beneficial ownership, or both. As such, the exchange could not be characterized as a wash trade as we define it.

55. Commenters identify additional transactions which would not meet our definition of a wash trade and therefore would not be prohibited under Market Behavior Rule 2(a). The New York ISO's identification of trades engaged in to correct a prior error, for example, would not constitute a prohibited wash trade under our rule, because trades such as these would not be "prearranged" to cancel each other out. In addition, each of the transactions described by the New York ISO would involve economic risk because the entity attempting to correct its mistake would be at risk for any price change which could occur over the time interval between the two trades. In fact, the purpose of the off-setting trade, in this instance, would be to address the economic risk imposed by the first trade.

56. Other commenters concerns are also misplaced. We do not agree, for example, that a legitimate "sleeve" or "bookout" transaction could be characterized as a prohibited wash trade under our definition. Specifically, a sleeve is not an off-setting trade but rather a mechanism to accomplish a power sale among parties that have not established a credit relationship (involving in the transaction chain a third

party seller that possesses the required creditworthiness).[35] Similarly, a "bookout" is not a pre-arranged trade but rather a subsequent arrangement to financially close out a trade that was not prearranged and was undertaken (and, in fact, closed out) with economic risk.

57. In addition, while we agree with EEI, that it may be easier to undertake a wash trade that occurs at the same location, it may also be possible to engage in wash trades that involve more than one location. As such, we decline to revise our proposed rule as EEI requests.

58. Commenters also argue that Market Behavior Rule 2(a) should be revised to include an intent standard, suggesting in effect that a wash trade could be executed without intent (or without an understanding as to its consequence) and should be excused, in this instance. We disagree. Wash trades, by their very nature, are manipulative and purposely so. By definition, parties to a wash trade intend to create prearranged off-setting trades with no economic risk. Thus, we know of no legitimate business purpose attributable to such behavior and no commenter has suggested one. Accordingly, wash trades, under our rule, will constitute a per se violation of Market Behavior Rule 2.

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[35] The two resulting sales (which are only offsetting to the "sleeving" seller) are each with economic risk, with a change in beneficial ownership and, usually, at slightly different prices to reflect the use of the "sleeving" sellers' credit.

D. Market Behavior Rule 2(b) (Prohibition Against Transactions Predicated on Submission of False Information)

1. Commission Proposal

59. In addition to the prohibition against market manipulation set forth in proposed Market Behavior Rule 2, we also proposed, as a specific action or transaction that would be prohibited, "transactions predicated on submitting false information to transmission providers or other entities responsible for operation of the transmission grid (such as inaccurate load or generation data; scheduling non-firm service or products sold as firm; or conducting 'paper trades' where an entity falsely designates resources and fails to have those resources available and feasibly functioning)."

2. Comments

60. Commenters raise three principal concerns regarding the proposed rule: (i) its failure to include an intent standard; (ii) its apparent prohibition against virtual trading practices already permitted in organized markets; and (iii) its reference to a practice, i.e., to "paper trades," for which, it is claimed, there is no common definition in the industry.

61. First, commenters assert that an intent standard should be adopted in order to protect sellers from the imposition of sanctions relating to inadvertent or honest errors that were not intended to manipulate market prices.[36] To address this issue, EPSA, et al. recommend that Market Behavior Rule 2(b) be re-

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[36] See Comments of EPSA, et al. at Attachment B, p.3; Comments of EEI at 14; Comments of AES at 26-27; Comments of FirstEnergy at 9; Comments of Reliant at 10.

vised to prohibit actions or transactions predicated on "knowingly" submitting false information to transmission providers or other entities responsible for operation of the transmission grid "with intent to manipulate the market."[37]

62. Related to this same concern, Dynegy notes that due to forecasting errors, load forecasts and generation data are rarely 100 percent accurate. Dynegy further notes that sellers often face unknowable circumstances relating to the timing and duration of derates or outages. Given these and related contingencies, Dynegy seeks clarification that Market Behavior Rule 2(b) is not intended to supersede or otherwise nullify existing practices and/or market rules which allow for variation between forecasted and actual outcomes. Similarly, AES seeks clarification that the proposed prohibition does not apply to situations where submitted load data or generation data was incorrect due to the occurrence of a legitimate and verifiable contingency, or situations that occur in the normal course of business and are separately governed by terms and conditions of tariffs already on file with the Commission.

63. EEI also raises concerns regarding the interplay between the proposed rule and the existing practice

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[37] EEI proposes a slight variation in this intent standard to prohibit actions or transactions "predicated on intentionally submitting false information to transmission providers including ISOs and RTOs (such as scheduling non-firm service or products sold as firm; or conducting 'paper trades' where an entity falsely designates resources and also fails to have those resources available and feasibly functioning)." See Comments of EEI at 14. See also Comments of Reliant at 10 ("transactions predicated on submitting information known to be false").

known as virtual trading.[38] EEI proposes that the following language be incorporated into the proposed rule: "This prohibition [i.e., the prohibition set forth in Market Behavior Rule 2(b)] does not apply to transactions such as virtual trading that are an intentional part of an RTO or ISO market design."[39] Finally, commenters assert that the term "paper trade" be deleted from the rule. Duke Energy claims, in this regard, that there is no common meaning in the industry for this term and thus it could refer to any number of transactions, many of which may be legitimate.

3. Commission Ruling

64. As discussed below, we will adopt Market Behavior Rule 2(b), subject to two revisions. As requested, we will adopt an intent standard applicable to our prohibition against the submission of false information to transmission providers or to other entities responsible for operation of the transmission grid, i.e., to be actionable under this rule, the seller's submittal must be knowingly false. Second, we will strike the example of "paper trades" from our illustrative, non-exclusive list of submissions subject to our rule. As revised, Market Behavior Rule 2(b) will prohibit:

> *Transactions predicated on submitting false information to transmission providers or other en-*

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[38] A virtual trade can be distinguished from a physical trade that is actually scheduled to the extent that it involves no actual purchase (physical acquisition) or sale (physical disposition) of electricity. It is a purely financial transaction designed to capture an arbitrage opportunity. See, e.g., PJM Interconnection, L.L.C., 104 FERC ¶ 61,39 (2003).

[39] The interplay between the Market Behavior Rules and virtual trading is also raised by commenters in connection with Market Behavior Rule 2(c), discussed below.

tities responsible for operation of the transmission grid (such as inaccurate load or generation data; or scheduling non-firm service or products sold as firm), unless Seller exercised due diligence to prevent such occurrences.

65. Commenters generally agree, as do we, that a Market Behavior Rule addressing market manipulation appropriately includes within its prohibitions the submission of false information to transmission providers or other entities responsible for operation of the transmission grid. As requested, however, we are approving this rule subject to the clarification that inadvertent or honest errors will not constitute a prohibited act under Market Behavior Rule 2. Rather, to be actionable under this rule, it must be shown that a seller has knowingly submitted false information.

66. This due diligence standard, however, will not be measured by the Commission with respect to the individual who actually tenders the data or who may otherwise be responsible for its submission. Rather, it will apply to the seller alone.[40] In this regard, we expect the seller to have in place processes that will assure the sufficiency and accuracy of the submitted information, regardless of who is actually responsible for submitting the information. Where a seller does not have such processes in place, it can be no defense to this rule that the submission of data was made by a particular individual who did not personally know it to be false or incomplete.

67. Dynegy requests clarification that Market Behavior Rule 2(b) is not intended to supersede existing

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[40] We make the same clarification, below, as it relates to Market Behavior Rules 2(d) and 3.

market rules which allow for variation between forecasted and actual demand or generation availability. We will grant Dynegy's request. We recognize that where required, both buyers and sellers submit information to transmission providers or other entities responsible for operation of the transmission grid based on forecasts. We understand that these forecasts are not and cannot be entirely accurate. Market Behavior Rule 2 (b), as approved herein, fully accommodates this reality by addressing the knowing submission of false information. Submitting information based on good faith estimates that turn out to be incorrect, then, would not be a case of knowingly submitting false information.

68. Commenters also express concern that Market Behavior Rule 2(b) could be read to prohibit Commission-approved activities such as virtual bidding. While we do not believe that virtual bidding is premised on the knowing submission of false information, we explained in the June 26 Order,[41] and reiterate here, that virtual bidding and other Commission-approved activities will not be considered actions taken in violation of our Market Behavior Rules. To underscore this point expressly (and as discussed above), we have revised the prohibition set forth in Market Behavior Rule 2 to provide that "[a]ctions or transactions undertaken by Seller which are explicitly contemplated in Commission-approved rules and regulations of an applicable power market (such as virtual supply or load bidding) are not in violation of the Market Behavior Rule 2."

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[41] June 26 Order, 103 FERC at n.18.

69. Finally, based on commenters' objections, we have omitted the example of "paper trade" from our non-exclusive, illustrative list of submittals subject to Market Behavior Rule 2(b). We agree with Duke that because the term "paper trade" has no common meaning in the industry, at this time, using such an example to clarify the scope and reach of Market Behavior Rule 2(b) would not be beneficial.

E. Market Behavior Rule 2(c) (Prohibition Against Transactions Relatingto the Creation of Artificial Congestion Followed by the "Relief" of Such Artificial Congestion)

1. Commission Proposal

70. In addition to the prohibition against market manipulation set forth in proposed Market Behavior Rule 2, we also proposed, as a specific action or transaction that would be prohibited, "transactions in which an entity first creates artificial congestion and then 'relieves' such artificial congestion."

2. Comments

71. Colorado Consumer Counsel, et al. argue that, in addition to the prohibition set forth in the proposed rule, the Commission should also address how all gradations of congestion will be managed in a wholesale market context and how market power, during periods of congestion, will be constrained.

72. Reliant asserts that the Commission's apparent focus in Market Behavior Rule 2(c) is on market designs like those in California that do not use locational marginal pricing (LMP) as a tool to manage congestion. Reliant states that, if so, the Commission should clarify that its rule does not apply in LMP markets. EEI also questions the need and scope of the rule,

noting that any transaction that would create "artificial congestion" would necessarily involve the submission of false information, as encompassed within the prohibition set forth in Market Behavior Rule 2(b). EEI and Pinnacle West also argue that the prohibition set forth in the rule should not apply to transactions that are consistent with an RTO's or an ISO's rules.

73. Reliant and EEI request that the Commission define what it means by "artificial congestion" because, in theory, this term could be construed to apply to (and thus be a sanction against) virtual transactions. Pinnacle West also requests clarification regarding the meaning of this term in this context.[42]

74. The New York ISO also claims that Market Behavior Rule 2(c) requires clarification with respect to the day-ahead and real-time markets it operates. Specifically, the New York ISO claims that the proposed rule could be interpreted to prohibit changes in day-ahead schedules in response to changes in market conditions between the day-ahead and real-time markets, i.e., to prohibit legitimate arbitrage between forward and real-time markets. Such a prohibition, it is argued, would be harmful to these markets because it would restrict market participants from responding in a competitive manner to the forces of supply and demand. The New York ISO explains that, in practice, congestion that may exist in the forward market may not exist in the real-time market, where market participants are permitted to respond competitively to these changed conditions. The New York ISO concludes that Market Behavior Rule 2(c) should be read to permit such responses in the real-time market.

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[42] See also Comments of the New York ISO at 12-13.

75. Commenters also assert that Market Behavior Rule 2(c) should be modified to incorporate an intent standard.[43] EPSA, et al. recommend that the prohibition apply to transactions in which an entity "intends to" first create artificial congestion and then relieve such artificial congestion.[44]

3. Commission Ruling

76. We will adopt Market Behavior Rule 2(c), subject to the inclusion of an intent standard, as requested by commenters. As revised, Market Behavior Rule 2(c) will address, as a prohibited transaction:

> *Transactions in which an entity creates artificial congestion and then purports to relieve such artificial congestion (unless Seller exercised due diligence to prevent such an occurrence).*

77. Commenters generally agree, as do we, that a Market Behavior Rule addressing market manipulation should include as an express prohibition transactions predicated on the creation and subsequent "relief" of artificial congestion. Experience has shown that in certain markets (including, in particular, markets that have not adopted an LMP market design) activities of this nature have been undertaken for the

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[43] See Comments of EPSA, et al. at Attachment B, pp. 3-4; Comments of Reliant at 10-11.

[44] See also Comments of Reliant at 10 (transactions in which an entity "intends first to create" artificial congestion and then "to purport to relieve" such artificial congestion); Comments of EEI at 15 ("intentionally engaging in transactions or scheduling resources that qualify for a congestion relief payment with the intent of profiting for relieving that congestion and canceling later is prohibited. This prohibition does not apply to transactions consistent with markets").

purpose of generating revenue without the occurrence of any corresponding economically substantive transaction.[45] Market Behavior Rule 2(c) makes clear that market manipulation of this sort, to the extent it can occur, has no legitimate business purpose and is therefore prohibited.

78. We agree with commenters, however, that Market Behavior Rule 2(c) should be revised to include an intent standard, i.e., that the prohibition set forth in this rule should be predicated on a seller having knowingly committed the prohibited conduct. As we held, above, in addressing the use of this intent standard in the context of Market Behavior Rule 2(b), however, this due diligence exception will be applied only to the entity subject to this rule, i.e., to the seller itself, not the individual acting on behalf of the seller who may have engaged in or otherwise authorized the prohibited conduct.[46] Moreover, we will find that the seller has knowingly violated this rule where the prohibited conduct is found to have occurred in the absence of adequate internal procedures designed to prohibit its occurrence.

79. Commenters also request clarification regarding the scope and definition of the term artificial congestion, as it will be interpreted by the Commission in the context of our rule. We will grant these requests and hereby clarify that artificial congestion, under our rule, will be understood to include all forms of congestion that may result from scheduling power flows

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[45] See Western Markets Report at VI at 26-30.

[46] We make this same clarification, below, as it relates to Market Behavior Rule 3.

in an uneconomic manner for the purpose of creating congestion (real or perceived).

80. Finally, the New York ISO seeks clarification that the prohibition set forth in Market Behavior Rule 2(c) is not intended to be applied in those cases where a market participant may be legitimately responding to changing circumstances relative to the day-ahead and real time markets. The New York ISO points out that from time-to-time, there may be a level of congestion in the day-ahead markets that is not present in real-time markets because market participants can respond to changing conditions. The New York ISO requests clarification that such real time responses to congestion that were anticipated in the day-ahead markets will not be prohibited under our rule. We will grant the requested clarification. The market responses addressed by the New York ISO reflect appropriate behavior which is reactive to the price signals emanating from the LMP congestion management system. Market conduct of this sort will not be characterized as a prohibited act under our rule.

F. Market Behavior Rule 2(d) (Prohibition Against Certain CollusiveActs)

1. Commission Proposal

81. In addition to the prohibition against market manipulation set forth in proposed Market Behavior Rule 2, we proposed, as a specific action or transaction that would be prohibited, "collusion with another party for the purpose of creating market prices at levels differing from those set by market forces."

2. Comments

82. Commenters generally support a market behavior rule directed towards non-competitive collusive acts

or transactions, but argue that Market Behavior Rule 2(d) should include language (and should be interpreted) consistent with federal antitrust laws and thus not read to create new or different norms of permissible behavior.[47] The New York ISO agrees, noting that the antitrust laws include a significant volume of precedents dealing with the appropriate meaning and scope of such terms as "collusion" and "unlawful constraints on competition."

83. The New York ISO also points out that Market Behavior Rule 2(d), in its proposed form, varies with federal antitrust laws in a way that it should not. Specifically, the New York ISO asserts that the term "for the purpose of creating market prices," as used in the proposed rule, suggests a reliance on an intent standard contrary to the accepted antitrust approach to collusion. In addition, the New York ISO argues that the proposed rule's focus on prices to the exclusion of non-price considerations is also inconsistent with federal antitrust law. Finally, the New York ISO suggests that the term "market forces," as used in the proposed rule, departs from the antitrust term "competition" and the focus of the antitrust laws on the "unreasonable restraint of competition."

84. The FTC also addresses these issues. The FTC points out that some seller conduct could violate both the antitrust laws and Market Behavior Rule 2, while other conduct could violate the Commission's rule (because it may be unjust and unreasonable) but not the antitrust laws. The FTC submits that to avoid po-

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[47] See Comments of the FTC at 13; Comments of EPSA, et al. at Attachment B, p. 4; Comments of EMI at 7; Comments of EEI at 15; Comments of Duke Energy at 37.

tential conflicts in policing anti-competitive behavior, the Commission should reaffirm its general rule that sellers with market-based rate authority are prohibited from engaging in conduct that would violate the antitrust laws.

3. Commission Ruling

85. We will adopt Market Behavior Rule 2(d), as revised, to prohibit Sellers from engaging in:

> *Collusion with another party for the purpose of manipulating market prices, market conditions, or market rules for electric energy or electricity products.*

86. To avoid possible confusion regarding the interpretation and scope of the term proposed in the June 26 Order (concerning "market prices [set] at levels differing from those set by market forces), we are replacing this term with language consistent our prohibition ("manipulating market prices, market conditions, or market rules for electric energy or electricity products"). Thus, we are prohibiting market manipulation undertaken by one seller acting alone and we are prohibiting market manipulation undertaken collectively.

87. As noted above, commenters, while disagreeing over the scope of our rule, generally agree that a specific market manipulation prohibition addressing collusive acts is both appropriate and necessary. EEI, for example, states that it agrees with the underlying concept embodied in the rule, while Duke concludes that the Commission's rule legitimately targets collusive activity. EPSA, moreover, as part of its code of

ethics and sound trading practices, has adopted a similar standard.[48]

88. EEI, however, suggests that our prohibition should simply incorporate by reference existing federal antitrust law and its jurisprudence, while EPSA, et al. (reaching the same conclusion) points out that the Commission's proposed prohibition is too vague and overbroad because, among other things, there is no widespread consensus in the industry on the meaning of the term "creating market prices at levels differing from those set by market forces."

89. We disagree with these assertions. While commenters are correct in their observation that the prohibition set forth in Market Behavior Rule 2(d), as applied, may be similar in certain respects to the prohibitions set forth in federal antitrust law, specifically to the prohibitions against unreasonable restraints of trade as set forth in the Sherman Anti-Trust Act,[49] our authority as it relates to Market Behavior Rule 2(d) derives not from federal antitrust law, but rather from the FPA itself and its requirement that all rates and charges made, demanded, or received by any public utility subject to our jurisdiction and all rules and regulations affecting or pertaining to such rates and charges be just and reasonable. Our approach includes elements of anti-trust law but is not limited to such. For example, it also encompasses "partner-

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[48] The EPSA standard prohibits parties from colluding with other market participants to affect the price or supply of power, allocate territories, customers or products, or otherwise unlawfully restrain competition.

[49] See 15 U.S.C. § 1 (2000).

ships" whose existence do not implicate anti-trust concerns.[50]

90. Thus, we need not address, here, whether or to what extent federal antitrust law may be broader in scope, in certain instances, or more narrow in scope, in other cases. Federal antitrust law, rather, will apply to sellers in the judicial proceedings or other authorized settings in which it is found to apply. Our rule, on the other hand, will be governed by the unique facts and circumstances at play in the wholesale electric industry and will be interpreted by the Commission consistent with our statutory duties relating to these issues.[51]

91. We also disagree that the Commission's standard is vague and overbroad and thus will not give sellers adequate notice of the conduct it requires or prohibits. While we address commenters' due process challenges in greater detail in Section N, below, we note here, with respect to Market Behavior Rule 2(d) in particular, that our rule merely expands upon the prohibition against market manipulation set forth in Market Behavior Rule 2. As discussed above, moreover, this prohibition is limited to actions or transactions that do not have a legitimate business purpose.

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[50] See Enron Power Marketing, Inc., et al., 103 FERC ¶ 61,346 (2003) (Enron Partnerships Order) (requiring Enron and other entities with whom it had partnerships or other arrangements to show cause why they should not be found to have jointly engaged in manipulation schemes).

[51] See, e.g., Pennsylvania Water & Power Co. v. FPC, 193 F.2d 230, 236 (D.C. Cir. 1951) ("A rate is not necessarily illegal because it is the result of a conspiracy in restraint of trade in violation of the Anti-Trust Act. What rates are legal is determined by the regulatory statute." [cit. omit.]).

As such, a seller cannot be found to have violated the prohibition set forth in Market Behavior Rule 2(d) where the conduct at issue (as known to the seller itself, in the first instance) has a legitimate business purpose. This limitation, we believe, puts sellers on adequate notice regarding the scope of our rule.

92. Finally, we do not agree that the industry lacks an understanding regarding the meaning of the terms referred to in our rule. These terms, rather, have more than a mere hypothetical or theoretical existence, as our recent experience relating to collusion in the Western markets aptly demonstrates.[52]

G. Market Behavior Rule 2(e) (Prohibition Against Certain BiddingBehavior).

1. Commission Proposal

93. In addition to the prohibition against market manipulation, as set forth in proposed Market Behavior Rule 2, we also proposed, as a specific action or transaction that would be prohibited, "bidding the output of or misrepresenting the operational capabilities of generation facilities in a manner which raises market prices by withholding available supply from the market."

2. Comments

94. Commenters challenge Market Behavior Rule 2(e) on a number of grounds. As a legal matter, EEI and others assert that the proposed rule is vague and overbroad, thus failing to provide market participants with sufficient notice of the conduct it would require or

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[52] See Enron Partnerships Order , 103 FERC at P46.

prohibit.[53] The New York ISO adds that the proposed rule fails to make any distinction between competitive and anti-competitive behavior or set a threshold that would permit market participants to have reasonable flexibility to adjust their bidding behavior in conformance with legitimate market forces. AES asserts that the proposed rule is vulnerable to misinterpretation and would require substantial oversight on the part of regulators.

95. Commenters also argue that the rule, if implemented, should adopt an intent standard, among other revisions. Reliant argues that inadvertent misrepresentations should not be considered violations of the rule and should not subject a seller to the same penalties that would attach to intentional violations. FirstEnergy adds that a seller should not be penalized for the types of action prohibited by the rule absent a showing that the actions at issue were intended to raise market prices above competitive levels.

96. Commenters also address whether and to what extent the proposed rule should define and more squarely address the concepts of physical withholding and economic withholding on an industry-wide basis.[54] Reliant asserts that its proposed definition of

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[53] See Comments of EEI at 17; Comments of Southern at 14; Comments of InterGen at 15; Comments of Reliant at 11.

[54] Reliant proposes that the rule be revised to adopt the following standard relating to physical withholding: Entities may not physically withhold the output of an Electric Facility (Generating unit or Transmission Facility) by (a) intentionally falsely declaring that an Electric Facility has been forced out of service or otherwise become unavailable, or (b) intentionally failing to comply with any applicable must-offer conditions of a participating generator agreement.

physical withholding would include an intent requirement and, with respect to subsection (b), would note that there may be legitimate reasons for not complying with a must-offer requirement.[55] EPSA, et al. add that the Commission's rule against physical withholding should include safe harbor language that would not require sellers to run their units in certain specified circumstances (e.g., when doing so would risk jeopardizing public health and safety or damaging the seller's facilities, in order to comply with facility licensing, environmental or other legal requirements; or when doing so would be uneconomic under the given circumstances).

97. Commenters also raise a number of concerns regarding the definition and scope of the term economic withholding, as it might be applied by the Commission under its proposed Market Behavior Rule 2(e) standard. The New York ISO asserts that any prohibition on withholding supply from the market should not be triggered by the inclusion of legitimate opportunity costs in a unit's bid. Reliant, on the other hand, asserts that defining what would and what would not constitute withholding under the proposed rule is virtually undoable.

98. Finally, EEI asserts that because Market Behavior Rule 1 and Market Behavior Rule 2(b) require sellers to operate their generation units consistent with RTO and ISO rules and prohibit the submission of false information, Market Behavior Rule 2(e) is redundant and unnecessary. The New York ISO claims that the

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[55] See also Comments of EEI at 16-17 (noting that generating capacity may be withheld from the market for reasons not associated with anti-competitive activity).

prohibitions contemplated by the rule could be implemented by existing market mitigation measures approved by the Commission.

3. Commission Ruling

99. We agree with commenters that Market Behavior Rule 2(e) is redundant and unnecessary and therefore will not adopt it. For the reasons discussed below, we find that Market Behavior Rule 1 sufficiently addresses the concerns we intended to address in proposing the express prohibition embodied in Market Behavior Rule 2(e).

100. Several commenters appear to have misread the intent of our proposed rule. They suggest that, if implemented, the proposed rule would have imposed a must-offer condition in markets in which such a requirement is not currently in effect. However, we did not intend to create this or any other new substantive obligation applicable to sellers, i.e., obligations other than those which already apply to sellers in the markets in which they operate. Our intent, rather, was simply to provide clarity regarding a specific form of market manipulation that would, as proposed, be expressly prohibited under Market Behavior Rule 2.

101. Because our proposed rule related to "bidding" into organized markets and to misrepresentations concerning the "operational capabilities of generation facilities," commenters are correct that the requirements addressed by our proposed rule were necessarily tied to the existing requirements of the applicable power markets in which sellers operate and thus were already addressed by the unit operation requirements addressed in Market Behavior Rule 1. Given this overlap, i.e., this redundancy in our proposed rules, we agree with those commenters who assert that Market

Behavior Rule 2(e), as proposed, is unnecessary and should be rejected.

102. In reaching this conclusion, however, we are not finding that physical withholding,[56] or economic withholding,[57] cannot be a component of an activity that constitutes market manipulation, as prescribed by Market Behavior Rule 2.[58] Nonetheless, we clarify here that seller's compliance with Market Behavior Rule 1, i.e., with the Commission-approved bidding and outage reporting rules in organized markets, should be sufficient to meet a sellers' obligations concerning bidding and reporting requirements with respect to a generating facility, absent seller's participation in manipulative conduct.

H. Market Behavior Rule 3 (Communications)

1. Commission Proposal

103. In the June 26 Order, we proposed that sellers be required to "provide complete, accurate, and factual information, and not submit false or misleading in-

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[56] The term "physical withholding" means not offering available supply in order to raise the market clearing price. Such a strategy is only profitable for a firm that benefits from the higher price in the market.

[57] The term "economic withholding" means bidding available supply at a sufficiently high price in excess of the supplier's marginal costs and opportunity costs so that it is not called on to run and where, as a result, the market clearing price is raised. Such a strategy is only profitable for a firm that benefits from the higher price in the market.

[58] To the extent this behavior violated any Commission-approved bidding rules in the applicable power market, moreover, it could also be found to be a violation of Market Behavior Rule 1.

formation, or omit material information, in any communication with the Commission, market monitors, [RTOs, ISOs], or similar entities." We sought comment on whether this proposed rule would be sufficient in its scope and breadth to cover any and all matters relevant to wholesale markets, including maintenance and outage data, bid data, price and transaction information, and load and resource data. In addition, we sought comment on whether this remedial authority would serve as a useful and appropriate tool in ensuring just and reasonable rates.

2. Comments

104. Commenters argue that the proposed rule should only prohibit violations knowingly committed.[59] Reliant points out that accidental violations, including mistakes made when responding to a request for data, or a reasonable but erroneous understanding of the type or scope of information requested, should not constitute a violation of the rule. EEI adds that unintentional errors and omissions occur in the ordinary course of business. Similarly, EPSA, et al. submit that market participants should retain the right to challenge requests for information and to exercise their judgment in determining the adequacy of a response, subject to subsequent direction from the Commission.

105. Commenters also favor limitation of the proposed rule to "Commission-approved entities" and thus the deletion of the proposed term "or similar en-

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[59] See Comments of EPSA, et al. at Attachment B, p.6; Comments of EEI at 18-19; Comments of Duke Energy at 38; Comments of Exelon at 13; Comment of Reliant at 18; Comments of MidAmerican Energy at 5.

tities."[60] Commenters argue that the application of the rule to entities other than jurisdictional entities would create unnecessary confusion and uncertainty. Undue market uncertainty is also alleged with respect to the potential scope of the proposed rule. Dynegy, for example, argues that the term "material information" creates an overly high and ambiguous standard that is not required to protect sophisticated commercial entities.[61] Similarly, Reliant submits that the word "complete" effectively requires sellers to become mind-readers in to order to avoid running afoul of the Commission's rule.[62] Amerada Hess asserts that it should be left to the RTOs, ISOs, and the market monitors to specify what does and what does not fall within the scope of the rule. Finally, commenters argue that the rule should be modified to require that any entity receiving data pursuant to the rule have appropriate data confidentiality protocols in place in order to ensure the confidentiality of the data it receives.[63]

3. Commission Ruling

106. We will adopt Market Behavior Rule 3, as revised. As revised, Market Behavior Rule 3 will require a market-based rate seller to:

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[60] See Comments of EPSA, et al. at Attachment B, p. 6; Comments of EEI at 18-19; Comments of Reliant at 18. But see Comments of the California Commission at 6 (proposing that the term "state regulatory authorities" be added to the list of entities to whom accurate information must be be provided).

[61] See also Comments of EPSA, et al. at Attachment B, p. 6 (noting that the word "material" is not currently defined).

[62] See also Comments of Central Vermont, et al. at 17.

[63] See Comments of Reliant at 18; Comments of EME at 8; Comments of Pinnacle West at 9.

Provide accurate and factual information and not submit false or misleading information, or omit material information in any communication with the Commission, Commission-approved market monitors, Commission-approved regional transmission organizations, Commission-approved independent system operators or jurisdictional transmission providers, unless Seller exercised due diligence to prevent such occurrences.

107. In adopting this rule, we are emphasizing the need for market-based rate sellers to act honestly and in good faith when interacting with the Commission or organizations and entities tasked by the Commission with the responsibility of carrying out non-discriminatory transmission access and wholesale electric market administration. The integrity of the processes established by the Commission for open competitive markets rely on the openness and honesty of market participant communications.

108. We have modified the proposed rule, however, to make clear that it will only apply to communications with the Commission and entities subject to its jurisdiction. We believe that such clarification is appropriate to assure sellers that the information sought or provided hereunder will be directly related to the wholesale transactions for which they have received market-based rate authority.

109. In addition, we clarify that this rule will not be a basis for a jurisdictional entity requesting or receiving information covered by this rule to compel the provision of such information or to fail to provide requested confidential treatment. The ability to compel the provision of information requested and determinations with respect to requests for confidential treat-

ment will depend on the Commission-approved rules and regulations of the institution requesting or receiving the information.

110. We have also revised the rule to assure that inadvertent submission of inaccurate or incomplete information will not be sanctioned. As revised, the rule prohibits the knowing submission of false or misleading data.[64] In this regard, we intend the "due diligence" exception to apply to the entity, not the individual, submitting the data. As such, we expect the seller submitting the information to have in place processes that assure the accuracy of the submitted information. The submission of false or incomplete information on behalf of a seller by an individual that did not personally know it to be false or incomplete in the absence of a process to insure data accuracy and sufficiency will not excuse the seller's conduct under this rule.

I. Market Behavior Rule 4 (Reporting)

1. Commission Proposal

111. In the June 26 Order, we applied the prohibition against false reporting, as set forth in proposed Market Behavior Rule 3, to the reporting of price data to publishers of electricity or natural gas price indices. We proposed that to the extent sellers engage in reporting of transactions to publishers of electricity or natural gas price indices, sellers will be required to provide complete, accurate and factual information to any such publisher. We further proposed that sellers would be required to notify the Commission of whether they engage in such reporting for all sales

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[64] As noted above, we make the same clarification as it relates to Market Behavior Rules 2(b) and 2(c).

and that in addition, sellers would be required to adhere to such other standards and requirements for price reporting as the Commission may order.

112. We noted that Staff, in the Western Markets Report, supported the inclusion of such a requirement in sellers' market-based rate tariffs and authorizations.[65] We sought comment on whether our rule, as proposed, would remedy the abuses outlined by Staff in the Western Markets Report by ensuring that published price indices represent a fair and accurate measure of actual prices and trading volumes. Finally, we noted that in Docket No. AD03-7-000, we were considering certain price formation issues, including a requirement covering the reporting of price data by jurisdictional entities.[66] Accordingly, we proposed to condition our rule by stating that "seller shall adhere to such other standards and requirements for price reporting as the Commission may order."

2. Comments

113. Issues raised by commenters with respect to the proposed rule generally mirror the concerns discussed above relating to Market Behavior Rule 3. These concerns include, principally, (i) the absence of an intent standard;[67] (ii) the need for confidentiality

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[65] See June 26 Order, 103 FERC ¶ 61,349 at P28, citing Western Markets Report at ES-17. We also noted that EPSA, in its code of ethics and sound trading practices, requires its members to "ensure that any information disclosed to the media, including market publications and publishers of surveys and price indices, is accurate and consistent."

[66] Id. at P31.

[67] See Comments of EPSA, et al. at Attachment B, pp. 6-7; Comments of EEI at 20; Comments of MidAmerican Energy at 5;

(*Footnote continued*)

when reporting transactions to publishers;[68] and (iii) the importance of clarifying the scope of the information to be reported.[69]

114. With respect to scope, Platts submits that if the Commission does require sellers to state whether they report "all sales" to publishers, the Commission should further specify the information it expects to be provided. Platts argues that sellers should be required in their notification to state whether they are reporting their prices for electricity transactions, gas transactions or both, and to state to which publications they are reporting prices. Platts adds that sellers should be required to state that the information they provide to publishers includes all of the company's trading at all North American trading points, not merely a complete set of data for those points at which a seller chooses to report data.

115. The Intercontinental Exchange, Inc. (Intercontinental) argues that since there are only a small number of index publishers relative to the hundreds of sellers, the Commission should compel index publishers to reveal the number of sellers reporting transaction-level data and the number of transactions reported for each index at each hub on a daily (for day-ahead indices) and monthly (for month-ahead indices) basis. Finally, NASUCA and TDU Systems argue that Market Behavior Rule 4 should require mandatory reporting in order to restore liquidity and confidence to

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Reliant at 20; Comments of National Energy Marketers Association at 13; Comment of PG&E at 11; Comments of EME at 10.

[68] See, e.g., Comments of EME at 10.

[69] See Comments of Central Vermont, et al. at 18; Comments of the FTC at 17-18; Comments of OPG at 5.

electricity and natural gas markets. NASUCA submits that this requirement should apply to all purchases as well as sales.

3. Commission Ruling

116. We will adopt Market Behavior Rule 4, as revised. As revised, Market Behavior Rule 4 will require that a market-based rate seller comply with the following:

> *To the extent Seller engages in reporting of transactions to publishers of electricity or natural gas indices, Seller shall provide accurate and factual information, and not knowingly submit false or misleading information or omit material information to any such publisher, by reporting its transactions in a manner consistent with the procedures set forth in the Policy Statement issued by the Commission in Docket No. PL03-3 and any clarifications thereto. Seller shall notify the Commission within 15 days of the effective date of this tariff provision of whether it engages in such reporting of its transactions and update the Commission within 15 days of any subsequent change to its transaction reporting status. In addition, Seller shall adhere to such other standards and requirements for price reporting as the Commission may order.*

117. In the June 26 Order, we referred to our on-going proceeding investigating price index formation in Docket No. AD03-7-000. As commenters note, since our proposal regarding these rules was issued, we have issued a Policy Statement addressing standards we believe appropriate for the formation of price indices that will be robust and accurate in the context

of a voluntary reporting regime.[70] Included in the Policy Statement is an allowance for a "safe harbor," pursuant to which reporting errors would not be subject to Commission sanction (e.g., as seller's conduct may relate to Market Behavior Rule 4).

118. In our rule, as revised herein, we explicitly adopt the standards set forth in the Policy Statement for transaction reporting. Further, we also adopt the "safe harbor" set forth therein as a component of our enforcement policy with respect to this rule. In addition, we make clear that all sellers will be required to inform the Commission of their "reporting status" within 15 days of the effective date of this revision to their tariff and within 15 days of any subsequent change in reporting status.

119. Finally, several commenters suggest that we require mandatory reporting, while other commenters contend that we have created requirements that will have a chilling effect on reporting. We believe that we have struck an appropriate balance in our rule. For the moment, we are attempting to work within the framework of voluntary reporting. We are awaiting Staff's review of the comprehensiveness of reporting in the wake of our Policy Statement. At this time, we are not mandating reporting. We have engaged in a comprehensive investigation of transaction reporting and related issues and believe the practices set forth in our Policy Statement represent the necessary minimum for those entities that choose to report. Accordingly, we will not require reporting, here, but will

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[70] See Price Discovery in Natural Gas and Electric Markets, 104 FERC ¶ 61,121 (2003).

set forth practical standards for entities that do report.

J. Market Behavior Rule 5 (Record Retention)

1. Commission Proposal

120. In the June 26 Order, we noted that in the Western Markets Report, Staff recommended that all electric market-based rate tariffs and authorizations be expressly conditioned to require sellers to retain data and information needed to reconstruct a published price index for a period of three years.[71] Based on Staff's recommendation, we proposed and sought comment on the record retention guidelines set forth in Market Behavior Rule 5. Specifically, we sought comment on whether this Market Behavior Rule, as proposed, would ensure that companies adopt suitable retention policies permitting the Commission and interested entities to better monitor these transactions and practices.

2. Comments

121. Commenters generally agree that a data retention requirement of some kind should be imposed on market-based rate sellers, but disagree over the number of years over which this requirement should apply. Some argue that the data retention period should be reduced from the proposed three-year period to a

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[71] See Western Markets Report at ES-14 and III-52. EPSA, in its code of ethics and sound trading practices, requires its members to "maintain documentation on all transactions for an appropriate period of time as required under applicable laws and regulations."

two-year or even one-year requirement,[72] others request that it be increased to a six-year or even seven-year requirement,[73] and others recommend that it be approved, as proposed.[74]

122. Commenters also raise concerns regarding the scope and specificity of the proposed requirement. EEI, Dynegy and MidAmerican, for example, argue that the language in the rule is too vague, while Exelon submits that the proposed rule would arguably require a seller to retain virtually every piece of paper it generates. These and other commenters conclude that without a more narrow, clearly articulated requirement, the proposed rule could be burdensome and costly.[75] Reliant requests clarification that the data retention requirement not extend to economic analyses associated with the development of prices and bids that underlie the prices charged by a seller (e.g., fuel cost, variable operation and maintenance expenses, or opportunity costs). In addition, Reliant argues that the products specified in Market Behavior Rule 5 be limited to jurisdictional products for which sellers have express authority to sell at market-based rates.

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[72] See Comments of Central Vermont, et al. at 18-19 (two years); Comments of Merrill Lynch, et al. at 9 (two years); Comments of FirstEnergy at 21 (two years) Comments of EPSA, et al. at Attachment B, p. 7 (one year).

[73] See Comments of NASUCA at 23 (six years); Comments of East Texas Cooperatives at 10 (seven years).

[74] See Comments of Reliant at 21.

[75] See, e.g., Comments of Duke Energy at 39-40.

3. Commission Ruling

123. We will adopt Market Behavior Rule 5, as revised. As revised, Market Behavior Rule 5 will require a market-based rate seller to:

> *Retain, for a period of three years, all data and information upon which it billed the prices it charged for the electric energy or electric energy products it sold pursuant to this tariff or the prices it reported for use in price indices.*

124. In revising this rule, we clarify that we are not seeking retention of "cost-of service" or analytical data related to all sales, as some commenters perceived from our use of the word "reconstruction" in our original proposal. Rather, we are requiring that sellers retain the complete set of contractual and related documentation upon which they billed their customers for their sales. The sales contemplated are sales made pursuant to the seller's market-based rate tariff. The Commission is indifferent as to whether this material is retained in paper form or in an electronic medium as long as the data can be made accessible in a reasonable fashion if its review is required by the Commission or its Staff.

125. In addition, commenters suggest that the length of the retention period may be burdensome. On balance, however, requiring sellers to retain records for the period proposed, i.e., for three years, will not constitute an undue burden on sellers, particularly given the fact that sellers can satisfy this requirement either by retaining their records in a hard copy form or electronically. To permit a shorter retention period may not allow sufficient time for the investigations into possible violations.

K. Market Behavior Rule 6 (Related Tariff Matters)

1. Commission Proposal

126. In the June 26 Order, we noted that in the Western Markets Report, Staff had found that sellers had failed to abide by their market-based rate codes of conduct[76] and their Order No. 889 standards of conduct.[77] We noted that these tariff provisions, among other things, required the functional separation of transmission and wholesale merchant personnel. We sought comment on whether Market Behavior Rule 6, as proposed, was sufficient in its scope and breadth to cover any and all matters relating to violations of the market-based rate codes of conduct and the Order No. 889 standards of conduct.

2. Comments

127. Notwithstanding the discussion which accompanied our proposed rule, commenters suggest that the language set forth in Market Behavior Rule 6, as proposed, could be construed to apply to codes of conduct other than sellers' market-based rate codes of conduct. Accordingly, commenters seek clarification that the codes of conduct to which Market Behavior Rule 6 refers are the codes of conduct contained in

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[76] The Commission requires a market-based rate code of conduct when a power marketer is affiliated with a public utility with a franchised service area and captive customers. See Carolina Power & Light Company, 97 FERC ¶ 61,063 (2001).

[77] See Open Access Same-time Information System and Standards of Conduct, Order No. 889, FERC Stats. & Regs. ¶ 31,135 (1996), order on reh'g, Order No. 889-A, FERC Stats. & Regs ¶ 31,049 (1997), reh'g denied, Order No. 889-B, 81 FERC ¶ 61,253 (1997).

sellers' market-based rate schedules. EEI also challenges the proposed rule as being too heavy-handed, permitting the Commission, in theory, to revoke a seller's market-based rate authority for any code of conduct or standards of conduct violation, no matter how small or insignificant the infraction (e.g., failing to correctly post a job description).[78]

3. Commission Ruling

128. We will adopt Market Behavior Rule 6, as revised. As revised, Market Behavior Rule 6 will require that a market-based rate seller:

> *Not violate or collude with another party in actions that violate Seller's market-based rate code of conduct or Order No. 889 standards of conduct, as they may be revised from time to time.*

129. Market Behavior Rule 6 is designed to emphasize our commitment to make certain that entities adhere to our electric power sales code of conduct and Order No. 889 standards of conduct. In response to commenter concerns, we have revised this rule to add clarity. In revising this rule, we clarify that this rule applies to a seller's electric power sales code of conduct contained in a Seller's market-based rate tariff or rate schedule as well as seller's Order No. 889 standards of conduct. We intend that any violation of this provision will subject the seller and its affiliates to disgorgement of unjust profits, as applicable, or other remedies as the Commission may find appropriate.

130. We further clarify that, in adopting this rule, it is not the Commission's intention to order disgorgement

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[78] See also Comments of EME at 11 (asserting that the proposed rule is vague and ill-defined).

of unjust profits or other remedies for inadvertent errors (such as incorrectly posting a job description). However, the Commission is concerned with all violations and, in particular, those violations which involve affiliate sales and preferential treatment, including access to transmission information or service.

L. Additional Rules and Alternative Options

1. Commission Proposal

131. In the June 26 Order, we noted that the prohibitions set forth in our proposed Market Behavior Rules represented only one of the tools available to the Commission to ensure just and reasonable rates and that in undertaking our enforcement decisions, we would focus on the best outcome for assuring just and reasonable rates in our jurisdictional markets. We stated that in some instances, significant remedial action may be warranted, while in other instances, we may use a specific set of facts and circumstances to clarify our requirements for acceptable public utility activities. We noted that in formulating our proposed rules, we were required to balance a number of competing interests. We sought comments from interested entities on whether our proposed rules struck the appropriate balance.

2. Comments

132. A number of commenters assert, in effect, that the Commission's proposed Market Behavior Rules fail to strike the necessary balance of interests, given the Commission's asserted failure to address various additional issues.

133. El Paso Electric Company (El Paso), for example, states that June 26 Order failed to examine or otherwise provide any understanding on a number of

important threshold questions underlying the Commission's stated objectives in this proceeding. Specifically, El Paso asserts that the Commission is attempting to articulate Market Behavior Rules without a full understanding of what constitutes a market, what dynamics foster a competitive market, and what kinds of behavior are beneficial or harmful.

134. The FTC points out that structurally competitive markets are generally the best remedy against anticompetitive behavior and that, as such, the Commission should give high priority to achieving structurally competitive markets while it pursues interim measures, if any, to address Market Behavior Rule violations. Similarly, EPSA, et al. submits that the solution for most of the alleged and actual inappropriate market behavior is well-functioning markets with clear and efficient rules that foster efficient investment and competitive behavior.[79]

135. In addition, commenters assert that the Market Behavior Rules should apply to all market participants, including transmission owners and load serving entities (LSEs). AE Supply argues that buyers who manipulate markets to depress prices should be subject to complaints by sellers to recover appropriate surcharges. EEI notes that this could be accomplished

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[79] See also Comments of East Texas Cooperative at 4-6 (stating that the lack of competitive markets remains a fundamental concern); Comments of ANP, et al. at 14 (the Commission should continue to rely on preventive measures tailored to specific markets, rather than adopting blanket rules that, by their own design, cannot stop anticompetitive behavior); Reply Comments of TDU Systems at 3 (noting that the Commission must address not only the behavior of market participants but the structure of the markets themselves).

by including the Market Behavior Rules in the tariffs administered by all RTOs, ISOs, and the Western Systems Power Pool.

136. APPA, TAPS, and TDU Systems propose that the Commission broaden the scope of its undertaking in this proceeding by addressing structural market issues. APPA and TAPS propose as additional rules, a requirement imposing long-term sales obligations for the benefit of LSEs, a requirement for capacity auctions to de-concentrate generation, and additional rules providing for greater access to transmission and the relief of existing transmission constraints. TDU Systems recommends that the Commission take action on its proposed supply reassessment screen to provide an up-front measure of a seller's potential market power.

3. Commission Ruling

137. We share the views of those commenters who assert that the Commission's proposed Market Behavior Rules, taken alone, will not be adequate to ensure that the rates, terms and conditions offered by market-based rate sellers will be just and reasonable. We also agree with EPSA, et al. and others that a well functioning market may be the best single, long-term remedy against the abuse of market power. In fact, the Commission is pursuing these efforts in other concurrent proceedings.[80]

138. As we have recognized in the past, however, even in a structurally competitive market, individual sellers

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[80] See, e.g., Midwest Independent Transmission System Operator, Inc., 105 FERC ¶ 61,145 (2003); California Independent System Operator Corporation, 105 FERC ¶ 61,140 (2003).

may have the ability to exercise market power. Individual sellers may have the ability to engage in market manipulation or other deceptive practices. Thus, it is appropriate that the Commission delineate well-defined rules of the road applicable to market-based rate sellers. Where these rules are violated, it is appropriate that the Commission provide a remedy for such conduct. It is important that such conduct be deterred to the extent possible.

M. Available Remedies and Complaint Procedures

1. Commission Proposal

139. In the June 26 Order, we indicated that in complaint proceedings brought before the Commission to enforce our proposed Market Behavior Rules, the principal remedy available to complainants for any Market Behavior Rule violation shown to have occurred (in addition to the potential revocation of the seller's market-based rate authority) would be the disgorgement of the seller's unjust profits attributable to the specific violation at issue.[81]

140. In addition, we proposed to limit the applicability of potential disgorgement of unjust profits exposure by requiring that any violation alleged by a market participant be made on a transaction-specific basis and that any market participant request for disgorgement relief be made no later than 60 days after the end of the calendar quarter in which the violation is alleged to have occurred. We proposed that if a market participant can show that it did not know and should not have known of the behavior which forms

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[81] June 26 Order, 103 FERC ¶ 61,349 at P38.

the basis for its complaint within the period prescribed in our proposal, then the 60-day period would be deemed to run from the time when the market participant knew or should have known of the behavior. Finally, we proposed that these time limitations not apply to enforcement actions undertaken by the Commission.

2. Comments

141. EEI rejects the remedial approach set forth by the Commission in the June 26 Order. EEI asserts that to avoid regulatory uncertainty, the Commission should only pursue remedies on a prospective basis after the Commission identifies new market problems and/or the need for new market rules.

142. Numerous comments (both pro and con) were received regarding the specific financial remedy proposed by the Commission, i.e., a disgorgement remedy. On the one hand, commenters challenge the Commission's authority to impose any remedies at all in this context based on various legal challenges (discussed below), the impracticalities involved in attempting to calculate such a remedy, and/or the commercial undesirability of doing so.[82] Other commenters stake out a position on the opposite end of

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[82] See Comments of EEI at 22-26; Comments of TransCanada at 4; Comments of Southern at 18 (noting that it may prove difficult, if not impossible, to calculate unjust profits in the context of market-based rates); Reply Comments of Mirant and TransAlta at 11 (noting that disgorgement liability could completely chill bulk power markets and severely limit capital market access for bulk power market participants); Reply Comments of Cinergy Services, Inc. (Cinergy) at 1-4 (arguing that a make-whole remedy would be unreasonable, unnecessary, impractical, and unauthorized by the FPA).

the spectrum, suggesting that a financial remedy limited to the disgorgement of unjust profits is entirely inadequate, unfair, and will not provide a sufficient deterrent against sellers who violate the Commission's rules.[83] The middle ground position between these two polar views, i.e., a disgorgement remedy that would not require the seller to make the market whole (as proposed by the Commission in the June 26 Order), is supported by EPSA, et al. and others.

143. Commenters also stake out a number of different positions regarding the Commission's proposed 60-day complaint limitation rule. EPSA, et al. and others submit that this complaint limitation proposal is both necessary and appropriate, as it relates to market participant complaints because, among other things, it will promote transactional certainty.[84] Others, including TDU Systems and East Texas Cooperatives, submit that this time limitation requirement will significantly undermine the Commission's overall objectives in this proceeding. Similarly, Central Maine, et al. argue for an extended period in which to file complaints, given (it contends) the complexity of an LMP-based market (and the time it requires to analyze market outcomes), the practicalities associated with billing cycles and correction periods, and the administrative burden associated with determinations of when a particular party knew or should have known of a rule violation. NECPUC submits that, at a mini-

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[83] See Comments of TDU Systems at 10; Nucor Steel, et al. at 7; SMUD at 6-7; PG&E at 3; Comments of Cal ISO at 5; Comments of NASUCA at 31; Comments of Cal Oversight Board at 5-6; Reply Comments of Central Maine, et al. at 8-9.

[84] See also Reply Comments of EEI at 12-13; Reply Comments of Cinergy at 4-6.

mum, the 60-day rule should be modified by providing all market participants 180 days to file a complaint from the date they know, or should know, of the violation at issue.[85]

144. Commenters also address the Commission's statement in the June 26 Order that it would not be bound by the 60-day complaint limitation requirement applicable to market participant complaints. On the one hand, the Louisiana Commission asserts that this 60-day complaint exemption is appropriate and that it should also apply to state regulators. On the other hand, EPSA, et al. and EEI warn that such an allowance would constitute an open-ended risk that the Commission might question any seller's transaction at any time (even in response to a hotline complaint made by a market participant otherwise precluded from filing a complaint) and would have a chilling effect on the market.[86]

145. Commenters seek a number of clarifications regarding the Commission's role in enforcing its Market Behavior Rules. EPSA, et al. seek clarification that while the Commission might reexamine transactions and provide guidance at any time, it will nonetheless be bound by the time limitation imposed herein with respect to any remedies it might impose. Central Vermont, et al. also seek a limitation on the Commission's authority in this area, proposing that there be a

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[85] See also Comments of SMUD at 5-6 (pointing out that a market participant that uncovers a violation on the last day of the calendar quarter has only one third the amount of time to prepare a complaint as a market participant who happens to find evidence of a violation on the first day of the calendar quarter); Reply Comments of TDU Systems at 5.

[86] See also Reply Comments of Mirant and TransAlta at 8.

time limit of six months following the date on which the violation is alleged to have occurred for the Commission to initiate an investigation and order disgorgement of unjust profits. The California Commission seeks clarification that a Commission Staff investigation initiated in response to an alleged tariff violation will be open to the public, noting that complaint proceedings initiated by other parties will necessarily be open to the public. Mirant and TransAlta also assert that the triggering event for bringing a complaint or initiating an investigation is unclear in the Commission's proposal. These entities propose that the triggering event be the time that the transaction at issue is entered into, absent fraud or the willful withholding of material information. Finally, Nucor Steel, et al. propose that revocation of a seller's market-based rate authority be made mandatory if it is determined that the seller is in violation of any Market Behavior Rule.

3. Commission Ruling

146. We will adopt the remedies and complaint procedures outlined in the June 26 Order, as revised (see Appendix B). Specifically, we will adopt the remedies and complaint procedures as they relate to market participant complaints, subject to the modification that the complaint limitation period will be 90-days, not 60-days, as proposed. Thus, a complaint must be brought within 90 days from the end of the calendar quarter in which the violation has been alleged to have occurred, unless a complainant can show that it did not know or should not have known of the behavior which forms the basis for its complaint within this time period.

147. Upon consideration of the comments received concerning our 60-day proposal, in the Commission's view the 60-day time period may be insufficient time for parties to discover and act upon violations of these rules. Accordingly, the Commission will modify its original proposal to allow 90 days from the end of the quarter from which a violation occurred for a party to bring a complaint based on these rules. A 90-day time period provides a reasonable balance between encouraging due diligence in protecting one's rights, discouraging stale claims, and encouraging finality in transactions. Furthermore, the Commission clarifies that its exception regarding the time period applicable to the filing of a complaint, where the complainant could not have known of the alleged violation, incorporates a reasonableness standard, i.e., the 90-day time period to file a complaint does not begin to run until a reasonable person exercising due diligence should have known of the alleged wrongful conduct. Rather than being impermissisibly vague, this safeguard ensures a sufficient time-period for complainants to discover hidden wrongful conduct and submit a claim.

148. We will also place a time limitation on Commission enforcement action for potential violations of these Market Behavior Rules. The Commission, unlike the market participants who may be buyers or otherwise directly affected by a transaction, may not be aware of actions or transactions that potentially may violate our rules. Thus, the Commission will act within 90 days from the date it knew of an alleged violation of its Market Behavior Rules or knew of the potentially manipulative character of an action or transaction. Commission action in this context means a Commission order or the initiation of a preliminary

investigation by Commission Staff pursuant to 18 C.F.R. § 1b. If the Commission does not act within this time period, the seller will not be exposed to potential liability regarding the subject transaction. Knowledge on the part of the Commission will take the form of a call to our Hotline alleging inappropriate behavior or communication with our enforcement Staff.

149. We will not adopt commenters' additional proposed revisions and arguments. First, we reject EEI's argument that the disgorgement remedy proposed in the June 26 Order is inappropriate, because, EEI asserts, it will retroactively or retrospectively declare actions to be market abuses when such actions were not envisioned when the rules were promulgated. In fact, EEI's premise is mistaken. Our Market Behavior Rules establish clear advance guidelines to govern market participant conduct. Moreover, in approving these Market Behavior Rules and requiring sellers to be fully accountable for any unjust gains attributable to their violation, we do not foreclose our reliance on existing procedures or other remedial tools, as may be necessary, including generic rule changes or the approval of new market rules applicable to specific markets.[87] As always, we will consider the full range of options available to the Commission to promote competition and to ensure that rates remain just and reasonable.

150. We also reject commenters' assertions that a disgorgement remedy may be difficult to calculate in a

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[87] Moreover, if Congress grants the Commission additional remedial power, including the authority to levy civil penalties, the Commission will, in addition to the remedies set forth herein, implement such authority and utilize it when appropriate for violations of these Market Behavior Rules.

particular case, or may operate as a chill on the market in other circumstances. The concerns raised by commenters, in this regard, are speculative at best. Moreover, any such concerns can be fairly evaluated by the Commission on a case-by-case basis, with a full opportunity for input from all interested parties. Thus, we need not reject a disgorgement remedy in all cases simply because it may be inappropriate to apply (and need not be imposed) in a specific case. For the reasons discussed below (see Section H, "Legal Authority") we will also reject the assertion that the Commission is precluded from applying a disgorgement remedy under Section 206 of the FPA or on due process grounds.

151. We also reject commenters' assertions that, in enforcing our Market Behavior Rules, the Commission should consider a make-the-market-whole remedy. In fact, the remedies outlined by the Commission in the June 26 Order, including the possible revocation of Sellers' market-based rate authority, will provide a sufficient inducement for sellers to comply with our rules. Our primary focus, in this regard, is on encouraging appropriate market behavior and deterring inappropriate market behavior.

152. Finally, we will reject the proposal made by Mirant and TransAlta that the triggering event applicable to market participant complaints be the date on which the transaction was entered into, absent fraud or willful withholding of material information on the part of the seller. We will not limit market participant complaints in this way. First, the Commission's Market Behavior Rules address both actions and transactions and thus cannot be limited to dates applicable to transactions alone. For example, the declaration of an outage, as addressed by Market Behavior Rule 1,

could be an action that does not necessarily involve a transaction.[88] Second, the June 26 Order was clear that the 60-day requirement would be triggered by the occurrence of the violation, which (in the case of a transaction) could come well after the transaction date. Finally, the extension of this 60-day period, we said, would be based on whether the complainant knew or should have known of the behavior which forms the basis for its complaint, not fraud or any other conduct that the complainant would be required to attribute to the seller as a pre-condition to its right to seek relief.

N. Legal Authority

1. Commission's Findings in the June 26 Order

153. In the June 26 Order, we concluded that Section 206 of the FPA would not bar the Commission from either approving or enforcing our proposed Market Behavior Rules.[89] We noted that we had initiated this proceeding under Section 206, for the purpose of examining whether sellers' market-based rate tariffs are just and reasonable, or whether, conversely, they should be revised as proposed herein. We stated that should we determine that sellers' currently effective

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[88] In this regard, while we held in the June 26 Order that our disgorgement remedy, in the context of a market-participant complaint, could only be sought on "transaction-specific basis," we clarify here that this requirement, as it relates to actions, need only refer to specific actions.

[89] See June 26 Order, 103 FERC ¶ 61,349 at P46. Our discussion of this issue, we noted, was prompted by the comments we received in response to the more broadly-stated tariff condition proposed in our Initial Order issued in this proceeding. See Initial Order, 97 FERC at 61,976 and note 4, supra.

tariffs are unjust and unreasonable or may lead to unjust and unreasonable rates without the inclusion of the market behavior rules we proposed herein, we would require that these tariffs be revised to include the rules prospectively, as Section 206 requires.

154. We also found that the refund limitations of Section 206(b) would not bar the Commission from enforcing our proposed Market Behavior Rules. We found that any remedies stemming from a violation of our proposed tariff provisions would be based on the tariff conditions themselves, as approved herein, and that we were fully authorized to take actions and impose remedies when tariffs are violated.

2. Comments

155. A number of commenters continue to challenge the Commission's authority to promulgate and/or enforce its proposed Market Behavior Rules, given the asserted limitations of Section 206 of the FPA.[90]

156. In addition, commenters also challenge one or more of the Commission's proposed Market Behavior Rules on due process grounds.[91] Southern, for example, argues that fundamental concepts of due process

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[90] See, e.g., Comments of EEI at 27; Comments of ANP. Inc., et al. at 6-10; Comments of Central Vermont, et al. at 3; Comments of Cinergy at 21; Comments of Duke Energy at 14; Comments of FPL Energy, LLC at 9; Comments of Mirant and TransAlta at 6; Comments of TransCanada at 6.

[91] See Comments of EEI at 23; Comments of Southern at 13; Comments of ANP Inc., et al. at 1012; Comments of BPA at 5; Comments of BP Energy Company at 4-5; Comments of Cinergy at 23; Comments of Duke Energy at 8; Comments of InterGen at 9; Comments of Mirant and TransAlta at 18; Comments of TransCanada at 5

require that standards of conduct be sufficiently clear and unambiguous so as to provide a reasonable guide by which to identify prohibited conduct.[92] Southern further asserts that basic principles of administrative law require agencies to provide regulated entities with adequate notice of the conduct expected of them.[93] Southern adds that an agency fails to provide fair notice if the regulations and other policy statements issued by the agency are so unclear that regulated entities are unable to identify with ascertainable certainty the standards with which the agency expects parties to conform.[94]

157. AE Supply points to two Commission cases in which the Commission required the proposed tariff provisions at issue to impose a more clear and specific obligation and suggests that applying this same degree of specificity here, the Commission's proposed rules do not pass muster. AE Supply states that in California Power Exchange,[95] the Commission held that a tariff provision addressing the improper use of market power could only prohibit specific actions or specific outcomes and required the utility to provide actual examples of the specific actions that would be prohibited. AE Supply further notes that in New York Independent System Operator, Inc.,[96] the Commission

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[92] See Comments of Southern at 13, citing Gates & Fox, Co. v. OSHRC, 790 F.2d 154, 155 (D.C. Cir. 1986).

[93] Id., citing Satellite Broadcasting Company, Inc. v. FCC, 824 F.2d 1, 3 (D.C. Cir. 1987); McElroy Electronics Corporation v. FCC, 990 F.2d 1351, 1358 (D.C. Cir. 1993).

[94] Id., citing Trinity Broadcasting of Florida, Inc. v. FCC, 211 F.3d 618, 628 (D.C. Cir. 2000).

[95] 88 FERC ¶ 61,112 at 61,265 (1999).

[96] 89 FERC ¶ 61,196 at 61,605 (1999).

rejected a proposed market power mitigation remedy, in part, because the New York ISO had not described with enough specificity the types of conduct that would trigger the imposition of the proposed measures and because the New York ISO had not established specific thresholds or bright line tests that would trigger the conclusion that market power had been exercised.

3. Commission Ruling

158. For the reasons discussed below, we find that: (i) the Commission is not barred by Section 206 of the FPA from approving Market Behavior Rules applicable to market-based rate sellers, or allowing as a remedy the disgorgement of unjust profits and other remedies, as discussed herein; and (ii) these Market Behavior Rules are not unduly vague or overbroad.

159. First, we reject the suggestion that the potential financial consequences for sellers found to be in violation of the Commission's Market Behavior Rules would violate the refund limitations set forth in Section 206(b) of the FPA.[97] As we noted in the June 26 Order, we initiated this proceeding under Section 206 for the purpose of examining whether sellers' market-based rate tariffs are just and reasonable, or whether, conversely, they should be revised as proposed herein. We stated that should we determine that sell-

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[97] Section 206(b) requires that any refunds made in a Section 206 proceeding initiated by the Commission on its own motion be based on a refund effective date no earlier than 60 days after the publication by the Commission of notice of its intent to initiate such a proceeding, or, in the case of a complaint, no earlier than 60 days after the complaint was filed. Section 206(b) also limits the refund effective period to five months after the expiration of such 60-day period.

ers' currently effective tariffs are unjust and unreasonable or may lead to unjust and unreasonable rates without the inclusion of Market Behavior Rules, we would require that these tariffs be revised, but only on a prospective basis, as Section 206 requires.

160. Our Market Behavior Rules will operate as conditions to the grant of market-based rate authority and the Commission, in such a case, has broad authority to impose conditions that will help ensure that rates are within a zone of reasonableness. We held in the June 26 Order and reiterate here that the approval of Market Behavior Rules, under these circumstances, and any future remedies imposed for their violation, would neither violate the filed rate doctrine nor the refund limitations of Section 206(b).[98]

161. Further, the Commission has the authority to impose the appropriate remedy where it finds that violations of its Market Behavior Rules have occurred.[99] In particular, we reject the argument that a violation of an existing condition of service may not be remedied by the Commission from the time the violation occurred. In fact, the courts have held that the Commission has this authority in the fully analogous context

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[98] See San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, et al., 97 FERC ¶ 61,121, 61,370 (2000), order on reh'g, San Diego Gas & Electric Company v. Sellers of Energy and Ancillary Services, et al., 97 FERC ¶ 61,275 (2001), appeal pending, Public Utilities Commission of the State of California, et al. v. FERC, Nos. 01-71051, et al. (9th Cir., June 29, 2001).

[99] See, e.g., Coastal Oil Corp, v. FERC, 782 F.2d 1249 (D.C. Cir. 1986).

presented by the Natural Gas Act (NGA).[100] The courts have also held that the Commission has a great deal of discretion when imposing remedies devised to arrive at maximum reinforcement of Congressional objectives.[101] In devising its remedy, the Commission is required to exercise its discretion to arrive at an appropriate remedy,[102] and to explore all equitable considerations and practical consequences of its action pursuant to its statutory delegation.[103]

162. In addition, this order is based upon the Commission's finding after hearing that existing tariffs are unjust and unreasonable under Section 206 of the FPA. In a proceeding brought pursuant to these rules, the issue would be whether the entity has violated its tariff. Therefore, in a remedial proceeding brought pursuant to these rules, unlike an FPA Section 206 investigation initiated by the Commission, the regulated entity has notice of the conditions required for service at the time of the implementation of the service con-

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[100] See Consolidated Gas Transmission Corp., et al., 771 F.2d 1536 (D.C. Cir. 1985) (holding that the Commission has the authority under Section 16 of the NGA to order retroactive refunds to enforce conditions in certificates).

[101] The courts have held that "the breadth of agency discretion is, if anything, at is zenith when the action assailed relates... to the fashioning of policies, remedies and sanctions." Columbia Gas Transmission Corp. v. FERC, 750 F.2d 105, 109 (D.C. Cir. 1984), quoting Niagara Mohawk Power Corp. v. FPC, 379 F.2d 153, 159 (D.C. Cir. 1967).

[102] Gulf Oil Corp. v. FPC, 536 F.2d 588 (3rd Cir. 1977), cert denied, 434 U.S. 1062 (1978), reh'g denied, 435 U.S. 981 (1978).

[103] Continental Oil Co. v. FPC, 378 F.2d 510 (5th Cir. 1967) and FPC v. Tennessee Gas Transmission Co., 371 U.S. 145 (1962).

ditions and the Commission may, at its discretion, fashion an appropriate remedy.

163. In addition, we find that our Market Behavior Rules, including specifically the prohibitions set forth in Market Behavior Rule 2 (relating to market manipulation), are not unduly vague on their face.[104] While constitutional due process requirements mandate that the Commission's rules and regulations be sufficiently specific to give regulated parties adequate notice of the conduct they require or prohibit,[105] this standard is satisfied "[i]f, by reviewing [our rules] and other public statements issued by the agency, a regulated party acting in good faith would be able to identify, with ascertainable certainty, the standards with which the agency expects parties to conform."[106] Our Market Behavior Rules will satisfy this due process requirement "so long as they are sufficiently specific that a reasonably prudent person, familiar with the conditions the regulations are meant to address and the ob-

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[104] We note that due process challenges regarding the application of our rules to a particular case are not presented in this proceeding. Thus, commenters' arguments are limited to a facial challenge to our rules, i.e., an assertion that one or more of our rules is vague in all its possible applications.

[105] See Freeman United Coal Mining Company v. Federal Mine Safety and Health Review Commission, 108 F.3d 358, 362 ((D.C. Cir. 1997) (Freeman).

[106] See General Electric Co. v. EPA, 53 F.3d 1324, 1329-30 (D.C. Cir. 1995) (holding that the agency's interpretation of its rules was "so far from a reasonable person's understanding of the regulations that [the regulations] could not have fairly informed GE of the agency's perspective.").

jectives the regulations are meant to achieve, would have fair warning of what the regulations require."[107]

164. As applied by the courts, this due process standard has been held to allow for flexibility in the wording of an agency's rules and for a reasonable breadth in their construction.[108] The courts have recognized, in this regard, that specific regulations cannot begin to cover all of the infinite variety of cases to which they may apply and that "[b]y requiring regulations to be too specific, [courts] would be opening up large loopholes allowing conduct which should be regulated to escape regulation."[109]

165. The Supreme Court has further noted that the degree of vagueness tolerated by the Constitution, as well as the relative importance of fair notice and fair enforcement, depend in part on the nature of the rules at issue.[110] In Hoffman, for example, the Court held that in the case of economic regulation (as opposed to criminal sanctions), the vagueness test must be applied in a less strict manner because, among other

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[107] See Freeman, 108 F.3d at 362. See also Faultless Division, Bliss & Laughlin Industries, Inc. v. Secretary of Labor, 674 F.2d 1177, 1185 (7th Cir. 1982) ("[T]he regulations will pass constitutional muster even though they are not drafted with the utmost precision; all that due process requires is a fair and reasonable warning.").

[108] See Grayned v. City of Rockford, 408 U.S. 104, 110 (1971) (holding that an anti-noise ordinance was not vague where the words of the ordinance "are marked by flexibility and reasonable breadth, rather than meticulous specificity.").

[109] See Ray Evers Welding Co. v. OSHRC, 625 F.2d 726, 730 (6th Cir. 1980).

[110] See Village of Hoffman Estates, et al. v. The Flipside, Hoffman Estates, Inc., 455 U.S. 489, 498 (1981) (Hoffman).

things, "the regulated enterprise may have the ability to clarify the meaning of the regulation by its own inquiry, or by resort to an administrative process."[111]

166. Applying these standards here, we find that our Market Behavior Rules satisfy the requirement of due process. Market Behavior Rule 1, for example, gives sellers "ascertainable certainty" that in operating and scheduling their generation facilities, undertaking maintenance, declaring outages, and committing or otherwise bidding supply, they must do so in a manner that "complies with the Commission-approved rules and regulations of the applicable power market." There can be no reasonable uncertainty, in this regard, as to what these broadly-practiced, generally-understood activities encompass in the wholesale electric utility industry (i.e., operating facilities, scheduling, undertaking maintenance, declaring outages, and bidding supplies). Nor can there be any reasonable doubt as to the "rules and regulations" to which the rule applies.[112]

167. Similarly, we cannot agree that the prohibitions against market manipulation, as set forth in Market Behavior Rule 2, are unclear in their requirement. It

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[111] Id. See also Texas Eastern Products Pipeline Co. v. OSHRC, 827 F.2d 46, 50 (7th Cir. 1987) ("Texas Eastern, as a major pipeline company, in which trenching and excavation are a part of its routine, had ample opportunity to know of the earlier interpretation, should have been able to see the sense of the regulations on their face, and if still in doubt Texas Eastern should have taken the safer position both for its employees and for itself.").

[112] In fact, as discussed above, we are adopting the clarification that the rules and regulations to which this rule refers are limited to "Commission-approved" rules and regulations.

should be noted, in this regard, that our requirement that seller's actions or transactions have a "legitimate business purpose" is intended to give sellers an opportunity to explain their actions, while still safeguarding market participants against market manipulation for which there can be no legitimate business purpose attached. Sellers will not be required to guess at the meaning of this term, as applied, then, because the term can only have meaning with specific reference to a seller's own business practices and motives, i.e., if the seller has a legitimate business purpose for its actions or transactions, it cannot be sanctioned under this rule.

168. Moreover, as fully discussed in the June 26 Order and reiterated above, there is an important justification underlying our prohibition against market manipulation. We must be able to protect market participants against abuses whose precise form and nature cannot be envisioned today. As we have previously stated, in establishing these rules, we have worked to strike a necessary balance. We have attempted to set forth with sufficient specificity the class of behaviors we intend to prohibit and to do so in a manner that will inform market-based rate sellers of the type of activities that are consistent with just and reasonable rates. At the same time, we have also attempted to maintain our ability to address particular activities and situations that cannot be envisioned today. Our Market Behavior Rules, we have said, are designed to codify our requirements and provide a regulatory vehicle for their enforcement going forward.

169. The Commission would not be able to fulfill its statutory responsibilities, however, if it established rules addressing future activities based only on the specificity of the past. While we have provided clarity

and specificity, where possible, with respect to our experience with past market conduct, we must also establish general rules to prohibit a class of behavior going forward if we are to adequately protect customers to ensure that rates are the product of competitive forces (and thus are just and reasonable). Thus, our Market Behavior Rules have been designed to meet these twin objectives – to be specific in order to inform sellers as to the type of behavior that is prohibited today, while containing enough breadth and flexibility to address new and unanticipated activities, as they may arise in the future.

170. In sum, we believe our Market Behavior Rules, as modified, explained and approved herein, put sellers and all market participants on fair notice regarding the conduct we seek to encourage and the conduct we seek to prohibit. Stripped to their essentials, these guidelines amount to the following: (i) act consistently within the Commission's established rules; (ii) do not manipulate or attempt to manipulate power markets; (iii) be honest and forthright with the Commission and the institutions it has established to implement open-access transmission and entities publishing indices for the purpose of price transparency; and (iv) retain associated records. Viewed in this context, there can be no reasonable uncertainty over the underlying objectives embodied in our rules or their requirements going forward.

171. Nonetheless, we are committed to making our Market Behavior Rules as specific as they possibly can be and thus, as discussed above, we are adopting a number of the revisions proposed by commenters in order to better focus and fine-tune the scope and application of our rules.

172. With respect to Market Behavior Rule 2, we have clarified that the rule applies to actions without a legitimate business purpose which are undertaken for the purpose of manipulation of wholesale power markets or prices and that actions which are explicitly contemplated in Commission approved processes such as virtual load or supply bidding are not considered manipulation.[113] We have further explained that implementing Market Behavior Rule 2, we will consider all of the relevant facts and circumstances surrounding the particular transaction in question to determine whether the market-based rates sellers actions were without a legitimate business purpose but rather taken to impact the competitive market in a manner inconsistent with just and reasonable rates. We recognize that our standard is necessarily nonspecific with respect to the particular activities it prohibits but believe that our explanation of its meaning and associated enforcement philosophy accompanying the rule make clear that we are acting to prohibit actions which create or are designed to create artificial prices which would not have existed in a competitive market but for the manipulative acts. We have provided specific examples of such acts in Market Behavior Rule 2(a) through 2(d).[114] As explained above, we expect our administration of this rule will

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[113] Statutes such as Section 10(b) of the Securities and Exchanges Act of 1937, 15 U.S.C. § 78j (2000), prohibit the usage of any "manipulative or deceptive device or contrivance" in connection with the sale of securities. Courts have recognized that specific examples of such prohibited activities would emerge over time while market participants understood that "market manipulation" related to certain types of practices.

[114] As noted above, we have also deleted proposed Market Behavior Rule 2(e).

provide a vehicle to highlight specific prohibited activities on a case-by-case basis.

173. We have also revised the language of Market Behavior Rules 3 and 4 to assure that inadvertent factual errors in communications will not sanctionable under our rules and, with respect to Market Behavior Rule 3, that only the Commission and entities relied upon by the Commission to implement open access transmission are the entities triggering seller's factual reporting obligations. We have also revised Market Behavior Rule 5 to make clear that we are not requiring "cost-based" or other data but rather the data upon which the seller based its market-based charges to its buyer and upon which it reported its transactions to index publishers.

174. In sum, we have carefully considered our proposal and the comments we have received in light of our obligation to assure that wholesale power rates are just and reasonable and that sellers subject to our regulation are fairly apprised of their obligations as participants in a competitive power market subject to Commission oversight. We believe the rules we are establishing herein will allow us to assure just and reasonable rates and provide an adequate basis for sellers to understand our expectations of them.

O. RTO/ISO Coordination Issues

1. Commission Proposal

175. In the June 26 Order, we noted that the Market Behavior Rules we were proposing would apply to any market-based rate sale, whether in the bilateral market or in an organized market, i.e., in the bid-based markets administered by RTOs or by an ISO. We stated that these Market Behavior Rules were in-

tended to complement any RTO or ISO tariff conditions and market rules that may apply to sellers in these markets.[115]

2. Comments

176. Commenters disagree over whether and to what extent the Commission's Market Behavior Rules should be applied in organized markets. Some argue that in these markets, the Market Behavior Rules should not apply.[116] The New York ISO, the New York Commission, and ELCON seek clarification, in this regard, that when a generator unit operates and bids within the automated mitigation procedure (AMP) thresholds established by the New York ISO, such behavior will not be treated as a violation of any Market Behavior Rule.

177. Others assert that the Commission's Market Behavior Rules should play a vital role in the organized markets. Central Maine, et al., for example, point out that market power problems have continued to plague the LMP markets, notwithstanding the oversight and intervention of market monitors.

178. EEI asserts that market participants should not be left with conflicting sets of rules and no guidance as to which applies or which takes precedence over the other. EEI recommends that where there is an inconsistency between the Market Behavior Rules and an RTO or ISO tariff provision approved by the Commission, the Market Behavior Rule should be treated as subordinate. This is appropriate, EEI argues, because the RTO or ISO tariff provision, in this instance,

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[115] See June 26 Order, 103 FERC ¶ 61,349 at P8.

[116] See Comments of AES at 5; Comments of Exelon at 5.

will be the product of a regional stakeholder process specifically suited to meeting regional energy market needs.

179. EPSA, et al., on the other hand, argue that while regional differences may be appropriate on various discrete matters, many of the Market Behavior Rules address generic issues and should be applied uniformly across all markets.

3. Commission Finding

180. In our discussion of Market Behavior Rule 1, above, we clarified that absent inclusion in a broader manipulative scheme addressed in Market Behavior Rule 2, compliance with the Commission-approved rules and regulations of an applicable power market, such as an ISO/RTO market, will serve as compliance with our behavioral rules.[117] However, in order to provide as much clarity as possible to market participants and market monitoring units (MMUs), we will also provide guidance concerning how we expect both these Market Behavior Rules and ISO/RTO rules to be applied and enforced by the Commission and MMUs.

181. As stated in our order issued in Docket No. RT03-1-000 (Communications with Commission-Approved Market Monitors), MMUs may be viewed as the "functional equivalent" of the Commission's staff and, for example, are not typically subject to our ex parte rules in communicating with the Commission or Commission Staff.[118] In this regard, in ISO/RTO tariffs,

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[117] See supra, Section A.

[118] See Communications with Commission-Approved Market Monitors, 102 FERC ¶ 61,041 (MMU Communications Order), order denying reh'g, 103 FERC ¶ 61,151 (2003).

we have approved certain limited authority to MMUs to enforce tariffs and implement sanctions for a market participant's failure to comply with tariff requirements.[119] In each case, the determination of a tariff violation and the sanctions imposed may be appealed to the Commission.

182. We believe it is appropriate to authorize MMUs to enforce certain ISO/RTO tariff matters if those matters are: (i) expressly set forth in the tariff; (ii) involve objectively-identifiable behavior; and (iii) do not subject the seller to sanctions or other consequences other than those expressly approved by the Commission and set forth in the tariff.[120] Beyond this defined MMU authority, sellers' behavior will be subject to direct Commission enforcement in the first instance, regardless of whether the behavior occurs in ISO/RTO administered markets or bilateral markets. Market-based rate authority has been granted to sellers not only based on a finding of lack, or mitigation, of market power, but also with the expectation that such seller will not act in an anti-competitive manner. Through our administration of these rules, the Commission can assure that anti-competitive behavior is not countenanced and that rates remain just and reasonable.

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[119] See, e.g., New York Independent System Operator, Inc., 96 FERC ¶ 61,249 (2001).

[120] With respect to such matters, we will rely on the MMUs to identify and take action with respect to a specific behavior covered in the tariff, subject to later appeal to the Commission. If the MMU does not take action in such a case, the seller, absent an appeal to the Commission, will not be exposed to subsequent Commission enforcement actions regarding behavior found acceptable by the MMU.

183. While MMUs may take actions as authorized by the ISO/RTO tariff, the Commission retains its responsibility to oversee tariff compliance on the part of any market-based rate seller. For example, a repeated pattern of tariff violations across several markets could lead the Commission to consider revoking a seller's market-based rate authorization. Further, except to the extent that enforcement authority has explicitly been authorized for an MMU in an ISO/RTO tariff, these behavioral rules will apply and be administered by the Commission.

184. The roles of the MMUs and the Commission will require the Commission staff and the MMUs to continue to forge a close working relationship. This process has been underway for some time. Commission Staff is coordinating data collection and reporting functions with MMUs, including developing appropriate triggers for referring compliance issues to the Commission. We expect an MMU to maintain an ongoing dialogue with our staff so that we are apprised at all times of the status of the markets and activities of market participants. If an MMU becomes aware of activities of a market participant that appear to violate that market participant's market-based rate tariff condition or other requirement that has not been assigned to the MMU for enforcement in the first instance, the MMU is expected to bring the matter to the attention of the Commission staff.[121]

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[121] We have stated that the MMUs "serve an important practical and unique function as the Commission's 'eyes and ears' in the marketplace, and are charged with reporting back to the Commission any problems and anomalies which they encounter so that the Commission may take appropriate action under the Federal Power Act." See MMU Communications Order, 102

(*Footnote continued*)

185. Therefore, the behavioral rules adopted by the Commission for market-based rates sellers will apply to all markets. To the degree these rules overlap with a clearly stated tariff provision for which the Commission has assigned the first-line enforcement authority with associated sanctions to a MMU subject to appeal to the Commission, we will defer in the first instance to the MMU, subject to possible review. The Commission will exclusively undertake consideration of all other asserted violations of these rules. The Commission staff and the MMUs will work together to act to comprehensively assure that the overall competitiveness of jurisdictional electricity markets is maintained.

186. In addition, as discussed in our consideration of Market Behavior Rule 1, absent a situation in which an activity is part of a broader manipulative scheme prohibited by Market Behavior Rule 2, a compliance with Commission-approved ISO and RTO rules (such as bidding consistent with the AMP process in the New York ISO) will be deemed in compliance with these market behavior rules.

P. Administrative Findings and Notices

1. Information Collection Statement

187. As noted above, the Market Behavior Rules approved herein will require jurisdictional market-based rate sellers, to the extent they engage in reporting of

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FERC at 61,091. In other words, the most important function an MMU performs is to provide feedback to the Commission in order for the Commission to take substantive action in accord with the statute. As we have stated, MMUs "are practically an extension, or a surrogate for, the Commission's own monitoring and investigative staff." Id.

transactions to publishers of electricity or natural gas price indices, to provide accurate and factual information and not submit false or misleading information or omit material information to any such publisher.[122] In addition, these Market Behavior Rules will require market-based rate sellers to retain certain records for a minimal period of three years, as required by Market Behavior Rule 5.[123]

188. Given these requirements, the collection of information set forth below has been submitted to the Office of Management and Budget (OMB) for review under Section 3507(d) of the Paperwork Reduction Act of 1995.[124] OMB's regulations require OMB to approve certain information collection requirements imposed by agency rule.[125] The Commission identifies the information provided for under this order as FERC-516, Electric Rate Schedule Filings.

Data Collection	Number of Respondents	Number of Responses	Hours Per Response	Total Annual Hours
FERC-516 (Reporting)	864	3	1.5	3,888
(Recordkeeping)	864	1	5.0	4,320
Totals			6.5	8,208

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[122] See Appendix A at Market Behavior Rule 4.

[123] Id. at Market Behavior Rule 5.

[124] 44 U.S.C. § 3507(d) (2000).

[125] 5 C.F.R. § 1320.12 (2003).

Total annual hours for Collection (reporting + recordkeeping) = 8,208

189. Information Collection Costs: The Commission seeks comments on the cost to comply with these requirements. It has projected the average annualized cost of all respondents to be: $252,720 (3,888 @ $65.00 per hour, for reporting) + $2,000,160 (4,320 hours @ $31.00 per hour + $1,866,240 maintenance/storage/recordkeeping) = $2,252,880.

190. OMB's regulations require it to approve certain information collection requirements imposed by agency rule. The Commission is submitting a copy of this order to OMB.

Title: Electric Rate Schedule Filings

Action: Proposed Collection

OMB Control No. 1902-0096

Respondents: Businesses or other for profit.

Frequency of Responses: On occasion.

Necessity of Information: The Market Behavior Rules approved herein will revise market-based rate sellers' tariffs and authorizations and are intended to ensure that rates and terms of service offered by market-based rate sellers remain just and reasonable.

Internal review: The Commission has reviewed the requirements pertaining to Market Behavior Rules 4 and 5 and has determined that these tariff conditions are necessary to ensure just and reasonable rates. These tariff requirements, moreover, conform to the Commission's plan for efficient information collection, communication, and management within the electric utility industry. The

Commission has assured itself, by means of internal review, that there is specific, objective support for the burden estimates associated with the information/data retention requirements.

191. Interested persons may obtain information on the information requirements by contacting the following: Federal Energy Regulatory Commission, 888 First Street, NE, Washington, D.C. 20426 [Attention: Michael Miller, Office of the Executive Director, Phone (202)502-8415, fax: (202)273-0873, e-mail: umichael.miller@ferc.gov.]

192. For submitting comments concerning the collection of information and the associated burden estimates, please send your comments to the contact listed above and to the Office of Management and Budget, Office of Information and Regulatory Affairs, Washington, D.C. 20503, [Attention: Desk Officer for the Federal Energy Regulatory Commission, phone: (202)395-7856, fax: (202)395-7285.]

2. Environmental Analysis

193. The Commission is required to prepare an Environmental Assessment or an Environmental Impact Statement for any action that may have a significant adverse effect on the human environment.[126] The Commission has categorically excluded certain actions from these requirements as not having a significant effect on the human environment.[127] The actions proposed to be taken here fall within categorical ex-

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[126] Order No. 486, Regulations Implementing the National Environmental Policy Act, 52 FR 47897 (Dec. 17, 1987), FERC Stats. & Regs. Preambles 1986-1990 ¶ 30,783 (1987).

[127] 18 C.F.R. § 380.4 (2003).

clusions in the Commission's regulations for rules that are clarifying, corrective, or procedural, for information gathering, analysis, and dissemination, and for sales, exchange, and transportation of natural gas that requires no construction of facilities.[128] Therefore, an environmental assessment is unnecessary and has not been prepared in connection with this order.

3. Regulatory Flexibility Act Certification

194. The Regulatory Flexibility Act of 1980 (RFA)[129] generally requires a description and analysis of final rules that will have significant economic impact on a substantial number of small entities. The Commission is not required to make such analyses if a rule would not have such an effect.[130]

195. The Commission does not believe that the Market Behavior Rules approved herein would have such an impact on small entities. Most of the sellers required to comply with the proposed regulations would be entities who do not meet the RFA's definition of a small entity whether or not they are under the Commission's jurisdiction. Therefore, the Commission certifies that this rule will not have a significant economic impact on a substantial number of small entities.

4. Document Availability

196. In addition to publishing the full text of this document in the Federal Register, the Commission provides all interested persons an opportunity to view and/or print the contents of this document via the Internet through FERC's Home Page

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[128] Id. at § § 380.4(a)(2)(ii), 380.4(a)(5), and 380.4(a)(27).

[129] 5 U.S.C. § 601-612 (2000).

[130] Id. at § 605(b).

(http://www.ferc.gov) and in FERC's Public Reference Room during normal business hours (8:30 a.m. to 5:00 p.m. Eastern time) at 888 First Street, N.E., Room 2A, Washington D.C. 20426

197. From FERC's Home Page on the Internet, this information is available in the eLibrary. The full text of this document is available on eLibrary in PDF and Microsoft Word format for viewing, printing, and/or downloading. To access this document in eLibrary, type the docket number excluding the last three digits of this document in the docket number field.

198. User assistance is available for eLibrary and the FERC's website during normal business hours by contacting FERC Online Support at FERCOnlineSupport @ferc.gov or toll free at (866)292-3676 or for TTY, contact (202)502-8659.

5. Effective Date and Congressional Notification

199. The Commission has determined that the Market Behavior Rules approved in this order do not constitute a "major rule" as defined in Section 351 of the Small Business Regulatory Enforcement Fairness Act of 1996. The provisions of 5 U.S.C. § 801 regarding Congressional review of Final Rules, therefore, do not apply to this order.

Q. Mirant Corp. v. FERC

200. On September 12, 2003, the Bankruptcy Court for the Northern District of Texas issued a "Temporary Restraining Order Against the Federal Energy Regulatory Commission" (TRO) in In re Mirant Corp. (Mirant v. FERC), Adversary Proceeding No. 03-4355, which enjoins the Commission "from taking any action, directly or indirectly, to require or coerce the [Mirant]

Debtors to abide by the terms of any Wholesale Contract [to which a Mirant Debtor is a party] which Debtors are substantially performing or which Debtors are not performing pursuant to an order of the Court unless FERC shall have provided the Debtors with ten (10) days' written notice setting forth in detail the action which FERC seeks to take with respect to any Wholesale Contract which is the subject of this paragraph."

201. Should the TRO be converted into a preliminary injunction, an action that the Commission opposes, the Commission will appeal that order. Despite the Commission's disagreement with the validity of the TRO and its expectation that the TRO (or a preliminary injunction) will be vacated on appeal, the Commission must comply with it until vacated. The TRO requires ten days' written notice before the Commission takes a proscribed action with respect to a covered Mirant Wholesale Contract. Accordingly, to the extent that this order requires Mirant to act in a manner proscribed by the TRO, the order will provide written notice to Mirant of the action that the Commission will take with respect to a covered Mirant Wholesale Contract.

The Commission orders:

(A) The Market Behavior Rules set forth in Appendix A to this order are hereby adopted, as discussed in the body of this order, to become effective 30 days from the date of issuance of this order.

(B) In compliance with this order, market-based rate sellers are hereby directed to include the Market Behavior Rules, as approved herein, at such time as they file any amendment to their market-based rates tariff or (if earlier) at such time as they seek contin-

ued authorization to sell at market-based rates (e.g., in their three-year update filings). Notwithstanding this time allowance, as applicable to sellers' compliance filings, the effective date for the tariff revisions approved herein shall be the effective date, as specified in ordering paragraph A, above.

(C) The Secretary shall promptly publish this order in the Federal Register.

(D) Southern's request for rehearing of the June 26 Order is hereby dismissed, as discussed in the body of this order.

(E) The entities listed in Appendix C to this order shall be treated as parties to this proceeding.

By the Commission. Commissioners Massey and Brownell concurring with separate statements attached.

(SEAL)

Linda Mitry
Acting Secretary

Appendix A

Market Behavior Rules

As a condition of market-based rate authority, [Company Name] (hereafter, Seller) will comply with the following Market Behavior Rules:

1. **Unit Operation:** Seller will operate and schedule generating facilities, undertake maintenance, declare outages, and commit or otherwise bid supply in a manner that complies with the Commission-approved rules and regulations of the applicable power market. Compliance with this Market Behavior Rule 1 does not require Seller to bid or supply electric energy or other electricity products unless such requirement is a part of a separate Commission-approved tariff or requirement applicable to Seller.

2. **Market Manipulation:** Actions or transactions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electricity products are prohibited. Actions or transactions undertaken by Seller that are explicitly contemplated in Commission-approved rules and regulations of an applicable power market (such as virtual supply or load bidding) or taken at the direction of an ISO or RTO are not in violation of this Market Behavior Rule. Prohibited actions and transactions include, but are not limited to:

   a. pre-arranged offsetting trades of the same product among the same parties, which involve no economic risk and no net change in beneficial ownership (sometimes called "wash trades");

b. transactions predicated on submitting false information to transmission providers or other entities responsible for operation of the transmission grid (such as inaccurate load or generation data; or scheduling non-firm service or products sold as firm), unless Seller exercised due diligence to prevent such occurrences;

c. transactions in which an entity first creates artificial congestion and then purports to relieve such artificial congestion (unless Seller exercised due diligence to prevent such an occurrence; and

d. collusion with another party for the purpose of manipulating market prices, market conditions, or market rules for electric energy or electricity products.

3. **Communications**: Seller will provide accurate and factual information and not submit false or misleading information, or omit material information, in any communication with the Commission, Commission-approved market monitors, Commission-approved regional transmission organizations, or Commission-approved independent system operators, or jurisdictional transmission providers, unless Seller exercised due diligence to prevent such occurrences.

4. **Reporting**: To the extent Seller engages in reporting of transactions to publishers of electricity or natural gas price indices, Seller shall provide accurate and factual information, and not knowingly submit false or misleading information or omit material information to any such publisher, by reporting its transactions in a manner consistent with the procedures set forth in the Policy Statement is-

sued by the Commission in Docket No.PL03-3 and any clarifications thereto. Seller shall notify the Commission within 15 days of the effective date of this tariff provision of whether it engages in such reporting of its transactions and update the Commission within 15 days of any subsequent change to its transaction reporting status. In addition, Seller shall adhere to such other standards and requirements for price reporting as the Commission may order.

5. **Record Retention**: Seller shall retain, for a period of three years, all data and information upon which it billed the prices it charged for the electric energy or electric energy products it sold pursuant to this tariff or the prices it reported for use in price indices.

6. **Related Tariffs**: Seller shall not violate or collude with another party in actions that violate Seller's market-based rate code of conduct or Order No. 889 standards of conduct, as they may be revised from time to time.

Any violation of these Market Behavior Rules will constitute a tariff violation. Seller will be subject to disgorgement of unjust profits associated with the tariff violation, from the date on which the tariff violation occurred. Seller may also be subject to suspension or revocation of its authority to sell at market-based rates or other appropriate non-monetary remedies.

Appendix B

Remedies and Complaint Procedures

Complaints alleging any violation of the Commission's Market Behavior Rules will be subject to the following remedies and procedures, in addition to all other remedies and procedures, as may be applicable, pursuant to the Commission's Rules of Practice and Procedure.

(1) Any complaint seeking relief for a violation of the Commission's Market Behavior Rules shall be made no later than 90 days after the end of the calendar quarter in which the violation is alleged to have occurred.

(2) If a complainant can show that it did not know and should not have known of the behavior which forms the basis for its complaint, within the period prescribed by these procedures, then the 90-day period will be deemed to run from the time when the complainant knew or should have known of the behavior.

(3) Commission action on a complaint not meeting the filing deadlines, as prescribed in these procedures, will be prospective only.

(4) The applicability of the Commission's disgorgement remedy in any complaint proceeding alleging a violation of the Commission's Market Behavior Rules will be limited by requiring that any such violation be shown to have occurred on a transaction-specific basis.

(5) The Commission will act within 90 days from the date it knew of an alleged violation of its Market Behavior Rules or knew of the potentially manipulative character of an action or transaction. Commission ac-

tion, in this context, means a Commission order or the initiation of a preliminary investigation by Commission Staff pursuant to 18 C.F.R. Section 1b. If the Commission does not act within this time period, the seller will not be exposed to potential liability regarding the subject action or transaction. Knowledge on the part of the Commission must take the form of a call to our Hotline alleging inappropriate behavior, communication with our enforcement Staff.

Appendix C

Entities Filing Comments and/or Reply Comments

AES Eastern Energy, L.P.
Allegheny Energy Supply Company, LLC
Amerada Hess Corporation
American National Power, Inc., PPL Energy Plus, LLC and Sempra Energy*
American Public Power Association and Transmission Access Study Group*
Bonneville Power Administration
BP Energy Company
California Electricity Oversight Board
California Independent System Operator Corporation
Public Utilities Commission of the State of California
Canadian Electricity Association
Central Maine Power Company, New York State Electric & Gas Corporation and Rochester Gas and Electric Corporation**
Central Vermont Public Service Corporation, El Paso Electric Company, Southern Indiana Gas & Electric Company & WPS Resources Corporation
City of Seattle, Washington
Colorado Office of Consumer Counsel, et al
Connecticut Department of Public Utility Control
Cinergy Services, Inc.
Duke Energy Corporation
Dynegy Power Marketing, Inc., et al.
East Texas Cooperatives
Eastern Energy, L.P.
Edison Electric Institute

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* Entities Filing Both Comments and Reply Comments

** Entities Filing Reply Comments Only

Edison Mission Energy
ELCON, et al.
Electric Power Supply Association, Independent Energy Producers of California, Independent Power Producers of New York, Inc. and the Western Power Trading Forum*
El Paso Electric Company
Entergy Services, Inc.
Exelon Corporation
Federal Trade Commission
FPL Energy, LLC
FirstEnergy Service Company
Intercontinental Exchange, Inc.
Intergen North America, L.P.
Louisiana Public Service Commission
Merrill Lynch Capital Services, Inc. (Morgan Stanley Capital Group, Inc.)
MidAmerican Energy Company
Mirant Americas Energy Marketing, L.P. and TransAlta Energy Marketing (U.S.), Inc.*
Modesto Irrigation District
Montana Consumer Counsel
Montana Public Service Commission
National Association of State Utility Consumer Advocates
National Energy Marketers Association
National Rural Electric Cooperative Association
New England Conference of Public Utility Commissioners
New York Independent System Operator
New York State Public Service Commission
NiSource Inc.
Northeast Utilities Service Company
Ontario Power Generation Inc.
PacificCorp
Pacific Gas and Electric Company

Pinnacle West Companies
PJM Industrial Customer Coalition
PLATTS
Powerex Corp.
PPL Montana, LLC and PPL EnergyPlus, LLC**
Reliant Energy Power Generation, Inc. and Reliant Energy Services, Inc.
Sacramento Utility District
Southern California Edison Company
Southern Company Services, Inc.
Steel Producers
TECO Energy, Inc.
TransCanada Companies
Transmission Dependent Utility Systems
Tucson Electric Power Company
Williams Energy Marketing & Trading Company

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations	Docket Nos. EL01-118-000 and EL01-118-001

(Issued November 17, 2003)

MASSEY, Commissioner, concurring in part:

The tariff conditions that the Commission approves today send a clear message to market-based rate sellers: don't lie, don't manipulate market conditions, don't violate market rules and don't collude with others. For sellers who choose to behave otherwise, the Commission now has the tools to sanction such bad behavior and we give notice of what some of those sanctions could be. This action should help to restore the faith in energy markets that has been lost in the last few years.

There is one aspect of today's order, however, that I would have written differently. I would not limit the monetary penalty for tariff violations to disgorgement of unjust profits. Market manipulation can raise the market prices paid by all market participants and collected by all sellers. In such a case, the appropriate remedy may be that the manipulating seller makes the market whole. I would prefer to not take this or any monetary remedy off of the table, but instead to allow the Commission the flexibility to tailor the remedy to the circumstances of each case.

This one concern with today's order should not be interpreted, however, as diminishing in any way my

enthusiastic support for this otherwise excellent order. I commend my colleagues for taking this important and much needed step.

For these reasons, I concur in part with today's order.

William L. Massey
Commissioner

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations	Docket Nos. EL01-118-000 and EL01-118-001

(Issued November 17, 2003)

BROWNELL, Commissioner, concurring:

1. We are adopting behavioral rules for market participants in the electric and natural gas markets. No one can question the good intention behind these behavioral rules. As I have stated before, if there are violations of our rules, regulations or policies, we must be willing to punish and correct. Concurrently, if there is misconduct by market participants that is intended to be anticompetitive, we must have the ability to remedy those market abuses.

2. Conversely, when we originally proposed behavioral rules, I had a number of concerns. I was concerned that the use of vague terms would create uncertainty and, thereby, undermine the good intentions of the rules. I feared that subsequent applications of the proposed behavior rules to real world actions could result in overly proscriptive "rules of the road" that will dampen business innovation and creative market strategies. The net effect would be less competition and the associated higher costs to consumers. I was concerned that we may be proposing a model that simply does not fit with the larger lessons we have learned in fostering competition over the past two decades, particularly in the gas market.

3. It is difficult to strike the right balance. I have carefully weighed the comments and believe the revisions and clarifications to the proposed behavioral rules achieve the appropriate balance. We clarify that these rules do not impose a "must offer" requirement. We revise the definition of manipulation to relate to actions that are "intended to or foreseeably could" manipulate markets. We add the exclusion that action taken at the direction of an RTO or ISO does not constitute manipulation.

4. Commenters also challenge the sufficiency of the term "legitimate business purpose" in distinguishing between prohibited and non-prohibited behavior. We clarify that transactions with economic substance, in which a seller offers or provides a service to a buyer where value is exchanged for value, are not prohibited behavior. Behavior driven by legitimate profit maximization or that serves important market functions is not manipulation. Moreover, I think it is important to recognize that scarcity pricing is the market response to a supply/demand imbalance that appropriately signals the need for infrastructure. For example, the high prices of 2000-2001 that reflected supply/demand fundamentals resulted in the first new power plants being constructed in California in ten years; price risk being hedged through the use of long-term contracting; and renewed efforts to correct a flawed market design.

5. We have also adopted measures that require accountability. A complaint must be brought to the Commission within 90 days after the calendar quarter that the manipulative action was alleged to have occurred. The 90-day time limit strikes an appropriate balance between providing sufficient opportunity to detect violations and the market's need for finality.

The Order also places a similar time limit on Commission action. As a matter of prosecutorial policy, the Commission will only initiate a proceeding or investigation within 90 days from when we obtained notice of a potential violation through either a hotline call; conversations with our enforcement staff; or notification from a market monitor.

6. While these rules are designed to provide adequate opportunity to detect, and the Commission to remedy, market abuses and are clearly defined so that they do not create uncertainty, disrupt competitive commodity markets or prove simply ineffective, competitive markets are dynamic. We need to periodically evaluate the impact of these behavior rules on the electric and natural gas markets. We have directed our Office of Market Oversight and Investigation to evaluate the effectiveness and consequences of these behavioral rules on an annual basis and include their analysis in the State of the Market Report.

Nora Mead Brownell

107 FERC ¶ 61,175
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell,
Joseph T. Kelliher, and
Suedeen G. Kelly.

Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations — Docket No. EL01-118-003

ORDER ON REHEARING

(Issued May 19, 2004)

1. Intervenors seek rehearing and clarification of the Commission's November 17, 2003 order in which we adopted certain Market Behavior Rules and related procedural guidelines applicable to sellers' market-based rate tariffs and authorizations.[1] For the reasons discussed below, we deny rehearing and grant, in part, and deny, in part, intervenors' requests for clarification.

Background

2. In the order that initiated this proceeding, on November 20, 2001, we proposed to condition all new and existing market-based rate tariffs and authoriza-

[1] Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 105 FERC ¶ 61,218 (2003) (Market Behavior Rules Order).

tions to include a prohibition against "anticompetitive behavior" and the "exercise of market power."[2] We issued this proposal, in the form of a proposed pro forma tariff provision, to address on an industry-wide basis the types of market abuses that had occurred in the western markets during 2000-01, which were only then being uncovered in our then-pending investigation of these markets.[3]

3. Numerous responsive pleadings were filed in response to our proposal. Commenters asserted, among other things, that a general prohibition against anticompetive behavior and the exercise of market power, alone, without greater specificity, would provide inadequate protection to market participants while giving sellers insufficient notice of the specific conduct our rule would require or prohibit. Commenters also questioned the extent to which the events then being investigated in the western markets provided an appropriate justification for new standards of conduct applicable to sellers in other markets.

4. In March 2003, Commission Staff issued its Final Report on the western markets in which it found that, absent clearly-stated behavioral standards governing sellers' conduct in the wholesale electricity markets, many of the market abuses found to have been committed in the western markets could also be commit-

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[2] See Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 97 FERC ¶ 61,220 (2001).

[3] For a summary of the actions taken by the Commission in response to these market conditions, see generally San Diego Gas & Electric Company, et al., 96 FERC ¶ 61,120 (2001).

ted by sellers in other markets.[4] Commission Staff therefore recommended that the Commission adopt a number of specific market rules applicable to sellers on an industry-wide basis.

5. Based on these recommendations and the comments filed in response to our initial proposal in this proceeding, we issued an order on June 26, 2003, in which we set forth, as a modified proposal, six proposed Market Behavior Rules.[5] In this modified proposal, we addressed with greater specificity than we had in our initial proposal, behavioral standards covering: (i) sellers' unit operation; (ii) market manipulation; (iii) communications; (iv) price reporting to index developers; (v) record retention; and (vi) related tariff matters. We also proposed that any seller found to have engaged in the behavior prohibited by our Market Behavior Rules be subject to a disgorgement remedy and any other appropriate non-monetary remedies such as revocation of seller's market-based rate authority.

6. Numerous comments were filed in response to our modified proposal. In the Market Behavior Rules Order, we found that intervenors largely supported the Commission's overall objectives in this proceeding and the general thrust of our proposed rules and procedural guidelines. However, we also noted that we had received a number of constructive suggestions for

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[4] See Final Report on Price Manipulation in Western Markets: Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices, Docket No. PA02-2-000 (March 2003) at ES-14-17.

[5] See Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations, 103 FERC ¶ 61,349 (2003)(June 26 Order).

fine-tuning the specific requirements embodied in our rules. Accordingly, we adopted our proposed Market Behavior rules, subject to certain modifications and clarifications, to become effective December 17, 2003.[6] We also adopted our proposed procedural guidelines, subject to modifications and clarifications, and addressed the application of our rules, as they relate to market monitoring matters, in the organized markets operated by regional transmission organizations (RTOs) and independent system operators (ISOs).

Requests For Rehearing and Clarification

7. On rehearing, intervenors renew a number of claims addressed in our prior orders in this proceeding, relating to the proper scope and interpretation of our Market Behavior Rules. In addition, intervenors renew numerous challenges regarding the procedural guidelines applicable to our rules and continue to challenge the legal findings made by the Commission both in the June 26 Order and in the Market Behavior Rules Order regarding the asserted vagueness of our rules and the Commission's statutory authority to approve these rules under Section 206 of the Federal Power Act (FPA).[7] As discussed below, the majority of these rehearing requests seek to either lessen, or even negate, the impact of our rules on sellers or,

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[6] In a companion issuance, we also modified natural gas market blanket certificates under subpart G of Part 284 of the Commission's regulations to contain many of the standards proposed in this proceeding, where applicable. See Final Rule, Docket No. RM03-10-000, Amendments to Blanket Sales Certificates, 105 FERC ¶ 61,218 (2003), order on reh'g, 107 FERC ¶ 61,174 (2004).

[7] 16 U.S.C. § 824e (2000).

conversely, seek to broaden the scope of sellers' potential liability, or propose additional, stiffer sanctions against sellers found to be in violation of these rules.

Discussion

8. For the reasons discussed below, we will deny rehearing of the Market Behavior Rules Order. In doing so, we reaffirm here the careful balance struck by our rules - between the rights of the individual seller, on the one hand, and the needs of market participants and the marketplace as a whole, on the other. As we have stated before and reiterate here, while sellers need to be given rules of the road that are clearly delineated, market participants must be given an effective remedy in the event anticompetive behavior or other market abuses are found to have occurred. While sellers need and deserve regulatory certainty in the form of rate certainty and transaction finality, the Commission, in the performance of its statutory duties, cannot be impaired in its ability to provide remedies for market abuses whose precise form and nature cannot be envisioned today. As we discuss in greater detail, below, our Market Behavior Rules strike this necessary balance in a way that will both protect market participants and promote competition in the wholesale electricity markets.

A. Due Process Requirements

The Market Behavior Rules Order concludes, as did the June 26 Order, that the Commission's Market Behavior Rules, including specifically the prohibitions set forth in Market Behavior Rule 2

(relating to market manipulation) are not unduly vague or overbroad.[8]

1. Requests for Rehearing

9. Cinergy Services, Inc. (Cinergy), Duke Energy Corporation (Duke), Puget Sound Energy, Inc.[9] (Puget Sound, et al.), Merrill Lynch Capital Services, Inc. and Morgan Stanley Capital Group Inc. (Merrill Lynch and Morgan Stanley), and Mirant Americas Energy Marketing, L.P. and Williams Power Company, Inc. (Mirant and Williams) argue that the Commission's Market Behavior Rules, including, in particular Market Behavior Rule 2 (our anti-manipulation standard) and its subparts, violate due process requirements. Specifically, these intervenors assert that our Market Behavior Rules are impermissibly vague and overbroad and, thus, do not give adequate notice of the behaviors they may prohibit or the actions they may require.

10. Cinergy suggests, for example, that the meaning of the term "without a legitimate business purpose," as employed in the preamble requirement of Market Behavior Rule 2, remains entirely undefined, despite the Commission's best efforts in the Market Behavior Rules Order to give this term sufficient meaning. Cinergy notes that the Commission's attempted clarifications of this term were themselves vague and ambiguous because, among other things, the terminology relied upon by the Commission has no commonly accepted meaning within the industry and it otherwise

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[8] Market Behavior Rules Order, 105 FERC ¶ 61,218 at PP 163-174.

[9] Joined by Avista Corporation and Avista Energy, Inc.

the subject of ongoing debate as to its meaning in a given case.[10]

11. Cinergy also states that while the Commission deleted from Market Behavior Rule 2 the term "market prices which do not reflect the legitimate forces of supply and demand" and did so in response to charges made by intervenors that this term was vague, the Commission nonetheless restated (and relied again) on this very term in the explanatory discussion accompanying its rule. Cinergy submits that these clarifications giving meaning to the term manipulative conduct under Market Behavior Rule 2 can only gain clarity (and thus pass Constitutional muster) as the market and future case law develop.

12. Intervenors conclude that, at present, Market Behavior Rule 2 and its subparts cannot be applied retroactively under any circumstances and therefore can only be applied, consistent with the requirements of fair notice and due process, on a prospective basis, i.e., after the Commission has articulated the applicability of its sanction relative to the facts of a particular case.[11] Intervenors also challenge our other Market Behavior Rules as well as our procedural guidelines on the grounds that they too are vague and overbroad.

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[10] Cinergy Request for Rehearing at 5-6 (citing the Commission's reliance on the terms "manipulative conduct" and "transactions without economic substance" in explanation of its term "without a legitimate business purpose.").

[11] Cinergy restates this same argument as a challenge to the Commission's section 205 authority. See Cinergy request for rehearing at 8-9 ("Under section 205, the Commission may place conditions in a tariff, but ... those conditions must be specific and the required actions must be capable of definition on the date they become effective.").

2. Commission Finding

13. The Commission's Market Behavior Rules, including the prohibitions relating to market manipulation, are not unduly vague.[12] Constitutional due process requirements mandate that the Commission's rules and regulations be sufficiently specific to give regulated parties adequate notice of the conduct they require or prohibit.[13] This standard is satisfied "[i]f, by reviewing [our rules] and other public statements issued by the agency, a regulated party acting in good faith would be able to identify, with ascertainable certainty, the standards with which the agency expects parties to conform."[14] The Commission's Market Behavior Rules satisfy this due process requirement. Our rules are "sufficiently specific that a reasonably prudent person, familiar with the conditions the regulations are meant to address and the objectives the regulations are meant to achieve, would have fair warning of what the regulations require."[15]

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[12] In this regard, we note that the due process challenges raised on rehearing are limited to challenges to the Commission's rules on their face, i.e., to assertions that the Commission's rules are vague in all possible applications. There are no due process rehearing claims challenging the application of the Commission's rules to a particular case.

[13] See Freeman United Coal Mining Company v. Federal Mine Safety and Health Review Commission, 108 F.3d 358, 362 ((D.C. Cir. 1997) (Freeman).

[14] See General Electric Co. v. EPA, 53 F.3d 1324, 1329-30 (D.C. Cir. 1995) (holding that the agency's interpretation of its rules was "so far from a reasonable person's understanding of the regulations that [the regulations] could not have fairly informed GE of the agency's perspective.").

[15] See Freeman, 108 F.3d at 362. See also Faultless Division, Bliss & Laughlin Industries, Inc. v. Secretary of Labor, 674 F.2d

(*Footnote continued*)

14. This due process standard, moreover, allows for flexibility in the wording of an agency's rules and for a reasonable breadth in their construction.[16] The courts have recognized, in this regard, that regulations cannot list all of the infinite variety of situations to which they may apply and that "[b]y requiring regulations to be too specific, [courts] would be opening up large loopholes allowing conduct which should be regulated to escape regulation."[17] The Supreme Court has further noted that the degree of vagueness tolerated by the Constitution, as well as the relative importance of fair notice and fair enforcement, depend in part on the nature of the rules at issue. For example, in the case of economic regulation (as opposed to criminal sanctions), the vagueness test is applied in a less strict manner because, among other things, "the regulated enterprise may have the ability to clarify the meaning of the regulation by its own inquiry, or by resort to an administrative process." Village of Hoffman Estates, et al. v. The Flipside, Hoffman Estates, Inc., 455 U.S. 489, 498 (1981).[18]

1177, 1185 (7th Cir. 1982) ("[T]he regulations will pass constitutional muster even though they are not drafted with the utmost precision; all that due process requires is a fair and reasonable warning.").

[16] See Grayned v. City of Rockford, 408 U.S. 104, 110 (1971) (holding that an anti-noise ordinance was not unconstitutionally vague where the words of the ordinance "are marked by flexibility and reasonable breadth, rather than meticulous specificity.").

[17] Ray Evers Welding Co. v. OSHRC, 625 F.2d 726, 730 (6th Cir. 1980).

[18] See also Texas Eastern Products Pipeline Co. v. OSHRC, 827 F.2d 46, 50 (7th Cir. 1987) ("Texas Eastern, as a major pipeline company, in which trenching and excavation are a part of its routine, had ample opportunity to know of the earlier inter-

(*Footnote continued*)

15. Applying these standards, we reiterate, here, as we found in the Market Behavior Rule Order, that our Market Behavior Rules satisfy the requirements of due process. Our rules provide sufficient notice of the conduct prohibited. Under Market Behavior Rule 2, for example, sellers are put on notice that actions or transactions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electricity products will be prohibited

16. The Commission has carefully considered the terms and requirements of its Market Behavior Rules and the comments it received in light of its obligation to assure that market-based rate sales are just and reasonable and the requirement that sellers have reasonable notice of the obligations and prohibitions to which they are subject as participants in a competitive market subject to Commission oversight. We find these rules necessary to assure that rates in the markets at issue will be just and reasonable, and that the rules are consistent with the constitutional requirements of due process.

B. Market Behavior Rule 1 (Unit Operation)

Seller will operate and schedule generating facilities, undertake maintenance, declare outages, and commit or otherwise bid supply in a manner that complies with the Commission-approved rules and regulations of the applicable power

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pretation, should have been able to see the sense of the regulations on their face, and if still in doubt Texas Eastern should have taken the safer position both for its employees and for itself.").

market. Compliance with this Market Behavior Rule 1 does not require Seller to bid or supply electric energy or other electricity products unless such requirement is a part of a separate Commission-approved tariff or requirement applicable to Seller.[19]

1. Requests for Rehearing and Clarification

17. Rehearing applicants challenge our determination that Market Behavior Rule 1 will not be allowed to serve as an independent basis to impose any new obligations on sellers or to further regulate the bilateral market.[20] The American Public Power Association and the Transmission Access Policy Study Group (APPA and TAPS) request clarification that this ruling will be limited in its application to Market Behavior Rule 1 and thus is not intended to shield bilateral market participants from liability for failing to follow any other market rules to which they may be subject. The National Association of State Utility Consumer Advocates (NASUCA) alleges as error the Commission's determination to not apply Market Behavior Rule 1 to bilateral transactions.

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[19] Market Behavior Rules Order, 105 FERC ¶ 61,218 at PP 18-23.

[20] Id. at P 21.

18. Consumer Advocates,[21] the California Electricity Oversight Board (Cal Oversight Board), and the California Public Utilities Commission (California Commission) allege as error the Commission's failure to include an affirmative real-time must-offer obligation as a basic requirement applicable to sellers' market-based rate authorizations. The Cal Oversight Board argues that such a requirement is necessary because a seller who may make no false statement regarding the operational capabilities of its units (and who thus could not be sanctioned to this extent), could nonetheless withhold its capacity from the market for manipulative purposes by simply refusing to tender a bid.

19. The California Commission argues that a must-offer requirement is a fundamental condition for a workably competitive market and that without such a requirement, physical withholding and other market power abuses may go unchecked. Consumer Advocates add that if a load serving entity (LSE) is relying on a particular seller to meet the LSE's required capacity reserve margin, the seller should have an obligation to make its power available to the LSE so long as the seller's plant is physically able to operate.

20. Consumer Advocates and the California Commission request clarification that Market Behavior Rule 1 prohibits both physical and economic withholding as those terms are defined by the Commission in the Market Behavior Rules Order, even in those markets

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[21] The Consumer Advocates are comprised of the following entities: the Colorado Office of Consumer Counsel; the Attorney General of the State of New Mexico; the Utah Committee of Consumer Services; the Public Utility Law Project of New York, Inc.; the National Consumer Law Center, Inc.; and Public Citizen, Inc.

that do not have their own Commission-approved prohibition.[22]

21. Other intervenors seek to narrow the application of the Commission's rule. Cinergy requests clarification that the Commission's rule will only apply to organized spot markets run by RTOs and not to any other transaction into, out of, or through an RTO. Merrill Lynch and Morgan Stanley allege as error the Commission's determination that Market Behavior Rule 1 will apply to power marketers in addition to entities that own or control generation. Merrill Lynch and Morgan Stanley argue that the Commission's rule cannot and should not apply to power marketers who do not own or control generation.

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[22] In the Market Behavior Rules Order, we found that to the degree physical withholding or economic withholding issues are the subject of an applicable power market's rules and regulations, seller's compliance with such rules and regulations will satisfy seller's compliance with Market Behavior Rule 1. We also found that to the degree physical withholding and economic withholding could be components of activities that might be found to constitute market manipulation in a given case under Market Behavior Rule 2. Id. at P 102. We noted that the term physical withholding means not offering available supply in order to raise the market clearing price (a strategy that would only be profitable for a firm that benefits from the higher price in the market). We also defined the term economic withholding to mean bidding available supply at a sufficiently high price in excess of the supplier's marginal costs and opportunity costs so that it is not called on to run and where, as a result, the market clearing price is raised (a strategy, again, that would only be profitable for a firm that benefits from the higher price in the market). Id. at notes 56 and 57.

2. Commission Ruling

22. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 1. The core requirement embodied in our rule - that sellers conduct their business in a manner that complies with the Commission-approved rules and regulations of the applicable power market - does not impose a substantive obligation on sellers independent of any other Commission-approved rule or regulation. As such, Market Behavior Rule 1 neither expands upon nor limits any right or obligation which may currently apply to sellers, or which may be found to apply in the future pursuant to a filing made under section 205, or a proceeding instituted under section 206. Instead, Market Behavior Rule 1 is intended to serve the purpose of reinforcing a seller's compliance obligation to adhere to Commission-approved rules and provides a remedy, with specified complaint procedures in those cases where a seller has failed to follow a Commission-approved rule or regulation.

23. The requests for rehearing, by contrast, seek to either expand the reach of Market Behavior Rule 1, in some cases, or narrow its application in other cases, by adding substantive content to the rule in the form of either new requirements (e.g., the imposition of a generic must-offer obligation) or exemptions from existing Commission-approved rules or regulations (e.g., the applicability of existing rules or regulations to power marketers). The rehearing applicants assert that under Market Behavior Rule 1, these requirements and/or exemptions should be applied to all sellers on a generic basis across all markets, notwithstanding any market-specific variations or rules which we have found to be appropriate in a given market. We decline to follow this approach here.

24. Market Behavior Rule 1 has been carefully crafted to underscore a market-based rate seller's obligation to follow Commission-approved rules and to serve as a remedial tool. As such, it cannot conflict with or defeat the objectives of existing Commission-approved rules or regulations in a specific market to which it requires compliance. While the Commission's policy objectives in recent years have included the approval of standardized rules and procedures in these markets, where appropriate, implementation of these rules and procedures has appropriately occurred, in large part, on a case-by-case basis. In doing so, moreover, we have recognized the validity of regional variations with respect to certain rules and practices. Accordingly, we will not consider here on a generic basis new rights and obligations applicable to sellers across all markets with respect to the operation of their units.

25. However, we will grant the clarification sought by APPA and TAPS concerning the interaction of Market Behavior Rule 1 with our other Market Behavior Rules. Specifically, a seller's actions which do not violate Market Behavior Rule 1 (because they do violate any Commission-approved rule or regulation in the applicable power market) could nonetheless be found to violate another Market Behavior Rule. For example, a seller's actions which standing alone do not violate Market Behavior Rule 1, could, when considered in context, be determined to constitute market manipulation under the circumstances prescribed by Market Behavior Rule 2.

26. We also reiterate that Market Behavior Rule 1 may apply to bilateral transactions where the actions undertaken by a contracting party are subject to the Commission-approved tariff, rules and regulations

that apply to the applicable power market. For example, where a seller under a bilateral agreement is required to schedule a service with the transmission provider in the applicable market, the seller must do so consistent with the Commission-approved rules and regulations relating to this action.

27. Since as noted above, Market Behavior Rule 1 does not impose a new stand-alone requirement on sellers, we will reject the requests for rehearing seeking to add to our rule a substantive, must-offer requirement. As we stated in the Market Behavior Rules Order, unless the seller is subject to a must-offer requirement pursuant to the applicability of a Commission-approved tariff or other specific Commission-approved obligation, the seller will not be subject to such a requirement under our rule. We also reject the implicit rationale underlying this request, i.e., that capacity withholding for an anti-competitive purpose can only be remedied by way of a generic must-offer obligation. In fact, where a seller intentionally withholds capacity for the purpose of manipulating market prices, market conditions, or markets rules for electric energy or electricity products, it has done so without a legitimate business purpose in violation of Market Behavior Rule 2.

28. We will also deny Cinergy's request that Market Behavior Rule 1 not be applied to certain Commission-approved rules and regulations in the applicable market, namely to transactions into, out of, or through an RTO. Market Behavior Rule 1 is intended to be industry-wide in its reach to the extent it implicates a Commission-approved rule or regulation. Cinergy offers no reason for limiting the scope of our rule and we decline to do so.

29. Finally, we will deny the request for rehearing submitted by Merrill Lynch and Morgan Stanley concerning the applicability of Market Behavior Rule 1 to power marketers who do not own or control generation. If the acts or transactions engaged in by a power marketer are subject to a Commission-approved rule or regulation in the applicable market, a power marketers' conduct in these markets will also be subject to the requirements of Market Behavior Rule 1.

C. Market Behavior Rule 2 (Market Manipulation)

Actions or transactions that are without a legitimate business purpose and that are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electricity products are prohibited. Actions or transactions undertaken by Seller that are explicitly contemplated in Commission-approved rules and regulations of an applicable power market (such as virtual supply or load bidding) or taken at the direction of an ISO or RTO are not in violation of this Market Behavior Rule.

1. Requests for Rehearing and Clarification

30. Cinergy, Duke, Puget Sound, et al., Merrill Lynch and Morgan Stanley, and Mirant and Williams challenge Market Behavior Rule 2 on the grounds that the rule, as adopted, is unconstitutionally vague and overbroad and that, as such, its prohibitions will be

both unlimited and unknowable.[23] Conversely, Consumer Advocates charge that these same alleged ambiguities will lead to a too-narrow application of the Commission's rule to the extent that sellers can rely on these alleged ambiguities to create loop holes or otherwise shield their conduct as "legitimate." Each of these rehearing applicants finds fault in the Commission's definition of market manipulation and the term "legitimate business practice," absent a more specific enumeration of the acts or transaction to which these standards will be applied.

31. The Edison Electric Institute (EEI) and the Electric Power Supply Association (EPSA), by contrast, seek only minor clarifications to these standards. Specifically, EEI and EPSA request clarification that the foreseeability test set forth in the rule will be applied by the Commission in a given case based on whether a reasonable person would have foreseen the manipulative conduct at issue.[24] Sempra Energy (Sempra), on the other hand, suggests that the clause "or forseeability could" is unnecessary to the extent that it restates the subjective intent standard already embodied in Market Behavior Rule 2. Sempra also requests clarification that, in contrast to this subjective intent standard, the lack of a legitimate business purpose is an objective element based on the nature of

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[23] These rehearing requests were addressed, in part, in Section A, above, in which we discussed the applicable case law and other legal issues relating to the rehearing applicants' due process challenges.

[24] By contrast, Merrill Lynch and Morgan Stanley assert that the reasonable person approach will, in all probability, increase the inefficiency of the complaint process and create regulatory uncertainty.

the conduct and does not refer to a seller's state of mind, i.e., to intent or knowledge of the seller. Sempra also requests clarification that both the intent requirement (a subjective test) and the lack of a legitimate business purpose (an objective test) must be demonstrated to support a violation under Market Behavior Rule 2.

32. EEI seeks clarification that where a seller is found to have complied with the Commission-approved rules of an RTO or ISO in a manner that was reasonable at the time, such a seller cannot be found to have violated Market Behavior Rule 2.

33. Merrill Lynch, Morgan Stanley, Mirant and Williams renew their request that Market Behavior Rule 2 include an express intent standard that does not rely on a foreseeability component. Specifically, Merrill Lynch and Morgan Stanley submit that a seller should not be found liable under Market Behavior Rule 2 absent a finding that (i) the seller had the ability to manipulate the market when it engaged in the behavior in question; (ii) the seller intended to manipulate the market when it engaged in the behavior in question; and (iii) the behavior in question caused the market manipulation.

34. NASUCA, on the other hand, argues that in adopting what it characterizes as a dual intent standard (requiring first a determination of whether the seller has a legitimate business purpose for its actions and then, second, whether the action is intended to manipulate markets), the Commission unfairly imposes on complainants and itself an undue burden, given the fact that neither a would-be complainant nor the Commission will have access to the data or information necessary to prove such claims. NASUCA requests that

the Commission delete its intent requirement from Market Behavior Rule 2 or, in the alternative, clarify that intent to manipulate is not an element of a prima facie case and that the burden to show that the actions were not intended to manipulate the market remain on the sellers. Similarly, the Transmission Dependent Utility Systems (TDU Systems) asserts that the Commission erred in including intent as an element of market manipulation.

35. Duke seeks clarification that in defining prohibited activity under Market Behavior Rule 2, the Commission will not equate bids made above marginal cost in competitive wholesale markets as manipulative or lacking a legitimate business purpose. Duke urges the Commission not to equate competitive outcomes with marginal cost.

36. Finally, the California Commission takes issue with the Commission's stated requirements regarding requested contract revisions by one party to a contract predicated on the allegation that the other party has violated the Commission's Market Behavior Rules.[25] The California Commission argues that a requirement that the complainant in such a case demonstrate that the violation had a direct nexus to contract formation and tainted contract formation itself is not explained by the Commission and is otherwise unjustified.

2. Commission Ruling

37. We will deny rehearing of the Market Behavior Rules Order as it relates to our market manipulation standard under Market Behavior Rule 2. First, for the

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[25] Market Behavior Rules Order, 105 FERC ¶ 61,218 at P 45.

reasons discussed in Section A, above, our market manipulation standard does not violate the due process requirement embodied in the U.S. Constitution. In fact, this due process requirement is satisfied here by a prohibition which puts sellers on clear notice that their actions and transactions must have a "legitimate business purpose," i.e., an intended or desired result that is consistent with the seller's authorized business activities. Because this purpose relates to the seller's own motives and business objectives, moreover, this purpose will in every case be known to the seller, by definition, even before the act or transaction is undertaken.

38. Moreover, the legitimacy of this conduct, as the Commission might view it in a given case, will also be known or knowable to the seller in the vast majority of cases. This is so because the seller's conduct, in most cases, will track or be related to established industry practices, as previously authorized or permitted by the Commission. While in other possible cases, the seller may have some uncertainty regarding the Commission's assessment of the legitimacy of its conduct (to the extent this conduct may be novel or otherwise untested) the seller in this instance will be free to defend its conduct before the Commission in any proceeding in which this conduct may be at issue. Due process under the law requires no more and would not prohibit the Commission from interpreting (and applying) its rules to the facts and circumstances presented in a case of first impression.

39. In addition, any uncertainty regarding the meaning or application of our rule has already been minimized in large part by a prohibition that has been carefully crafted in its scope. By its terms, our rule addresses only actions or transactions that can have no legiti-

mate business purpose and which are intended to or foreseeably could manipulate market prices, market conditions, or market rules. Market Behavior Rule 2 is further narrowed in its reach to exclude acts explicitly contemplated by Commission-approved rules and regulations in the applicable power market or acts taken at the direction of an ISO or RTO.

40. We will also deny the requests for rehearing seeking greater specificity in the meaning of the term "legitimate business purpose." Consumer Advocates assert that specificity is necessary in order to prevent sellers from fabricating any number of "legitimate business purposes" as a defense to their otherwise manipulative conduct. On the other hand, others assert that this specificity is required in order to limit sellers' potential liability to specifically enumerated acts or transactions. These rehearing applicants therefore request additional clarifications regarding the possible application of our standard to specific conduct.

41. However, we decline to consider here the various hypothetical applications of our standard in a given case, beyond the specific prohibitions addressed in the four subparts to Market Behavior Rule 2. While clarifications of this sort would arguably give our rule greater definition, as to that conduct to which these clarifications might squarely apply, they might also invite the creation of loopholes which could be used by sellers for the purpose of avoiding our rule. As such, this specificity could have the unintended effect of excluding from our prohibition conduct which should be prohibited. Our rule, instead, has been designed to remain flexible in a way that will both comport with the requirements of due process and serve to prohibit all forms of market manipulation, includ-

ing market abuses whose precise form and nature cannot be envisioned today.

42. Several parties have argued that intent or foreseeability[26] should not be part of the definition for market manipulation or otherwise request that the definition be modified.[27] We decline to do so. In the Market Behavior Rules Order, we stated that in determining whether an activity has violated our rules, we would examine all relevant facts and circumstances surrounding the activity to establish its purpose and intended or foreseeable result. If that intended or foreseeable result is the manipulation of market prices, market conditions or markets rules, then the seller will be found to have violated the rule against market manipulation. With the exception of subpart 2(a) Wash Trades, which is a per se violation, all of the subparts of Market Rule 2 are subject to this standard.

43. In considering the foregoing, we will look to determine whether the action or transaction was undertaken with a legitimate business purpose. For example, we explained in the Market Behavior Rules Order that if the behavior was undertaken to provide service to a buyer with rates, terms and conditions disciplined by the competitive forces of the market, we would find the transaction to have a legitimate business purpose. Since the underlying purpose of an action is not always obvious and conclusions regarding the intent of others are often a matter of judgment, we

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[26] Of course, the concept of foreseeability includes the concept of reasonableness. As defined by Webster's Third New International Dictionary, "foreseeable" means: "being such as may be reasonably anticipated."

[27] See, e.g., NASUCA, Merrill Lynch and Morgan Stanley, EEI, and EPSA.

found that we would base our enforcement of this rule on a careful consideration of the facts and circumstances of the conduct at issue, recognizing that intent must often be inferred therefrom.

44. In developing this standard, we recognized that actions without a legitimate business purpose which would foreseeably result in a distorted price not reflective of a competitive market are appropriately attributed to the seller as manipulative acts. Accordingly, our standard looks to place such conduct in context; it considers the facts to discern the purpose of the conduct; and takes action when the seller's action was intended to or foreseeably would manipulate the market. All of the foregoing elements are related and the Commission will consider them all in considering potential violations of this rule.

45. Finally, we will deny rehearing regarding our clarifications in the Market Behavior Rules Order concerning requests made by a contracting party to modify its contract based on the allegation that the other party to the contract has violated our Market Behavior Rules. In the Market Behavior Rules Order, we held that our Market Behavior Rules could not be used as a vehicle, in this context, to support or justify the abrogation of a contract, unless the rule violation at issue has a direct nexus to contract formation and thus tainted the contract itself. In fact, this clarification was nothing more than a restatement of a principle applicable to the interpretation and enforcement of contracts and the Commission's own policies with respect to contract abrogation.[28]

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[28] In addition, we note that these rules will not supersede or replace parties' rights under section 206 of the FPA to file a

(*Footnote continued*)

D. Market Behavior Rule 2(a) (Prohibition Against Wash Trades)

Prohibited actions and transactions include, but are not limited to: (a) pre-arranged offsetting trades of the same product among the same parties, which involve no economic risk and no net change in beneficial ownership (sometimes called "wash trades").

1. Requests for Rehearing and Clarification

46. The Cal Oversight Board and NASUCA argue that the Commission's definition of a "wash trade," in subpart (a) of Market Behavior Rule 2, is unnecessarily narrow in its reach by including within its sanction transactions involving the same parties, the same quantity and no economic risk. The Cal Oversight Board asserts that a seller can too easily evade the Commission's rule by only slightly altering a price or quantity term in a transaction that may in substance and intent be a wash trade, or by making an arrangement with an independent or affiliated third party. NASUCA adds that the Commission should reconsider its definition of wash trade to include transactions of de minimis value.

47. Puget Sound, et al. and Sempra Energy request clarification that energy exchanges at different locations entered into by sellers to avoid the need for transmission service and performed on terms that do not involve different prices or a net transfer of benefi-

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complaint contending that a contract should be revised by the Commission, pursuant to either the "just and reasonable" or "public interest" tests as required by the contract.

cial ownership will not be regarded as a prohibited wash trade. In addition, Merrill Lynch and Morgan Stanley assert as error the Commission's determination that a wash trade can involve more than one location. Merrill Lynch and Morgan Stanley note that, in fact, under the Commodity Exchange Act, the prohibition against wash trades in the futures market is limited to the same delivery point. In addition, Merrill Lynch and Morgan Stanley request that subpart (a) of Market Behavior Rule 2 be revised to expressly address the temporal element of a wash trade, i.e., that a wash trade be defined as simultaneous or nearly so (within seconds of each other).

48. Finally, EPSA argues that in order to insure clarity, the Commission should conform its tariff prohibition against wash trades with the corresponding legislative prohibition against "round trip trading" currently pending before Congress.[29]

2. Commission Ruling

49. We will deny rehearing regarding our adoption of a specific prohibition against wash trades. As we noted

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[29] EPSA cites the following proposed language:

SEC. 220(b) For the purposes of this section, the term "round-trip trade" means a transaction, or combination of transactions, in which a person or other entity (1) enters into a contract or other arrangement to purchase from, or sell to, any other person or other entity electric energy at wholesale; (2) simultaneously with entering the contract described in paragraph (1), arranges a financially offsetting trade with such other person or entity for the same quantity of electric energy so that, collectively, the purchase and sale transactions in themselves result in no financial gain or loss; and (c) has the specific intent to distort reporting revenues, trading volumes, or prices.

in the Market Behavior Rules Order, a seller who engages in a wash trade does so for the purpose of sending an inaccurate price signal to the marketplace and then benefiting, or attempting to benefit (or having the capacity to benefit), from the trading opportunities that may arise as a result. Specifically, a seller engaging in a wash trade may have the ability to manipulate market prices by creating the illusion of trading activity (i.e., market liquidity) in a given market and/or the illusion of price movement. The seller may then attempt to "cash in" in the form of a third party transaction when the price is right. Under Market Behavior Rule 2(a), however, the triggering event in this chain of manipulation, i.e., the wash trade, is expressly prohibited when it involves a pre-arranged offsetting trade of the same product among the same parties and involves no economic risk and no net change in beneficial ownership.

50. NASUCA disagrees with the Commission's definition of wash trades. NASUCA argues that trades that involve de minimis value should be included in the definition of wash trades because such trades could be used to circumvent the rule and manipulate market prices just as easily as wash trades of no value. Merrill Lynch and Morgan Stanley argue that the Commission should clarify the parameters of a prohibited wash trade by limiting the designation to trades that occur at the same delivery point and requiring prohibited wash trades to be "simultaneous," or within seconds of each other.[30]

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[30] See Merrill Lynch and Morgan Stanley's Request for Rehearing at 13.

51. The Commission declines to modify its definition of wash trades based upon these comments. Under our prohibition, it must be shown that the seller has purposefully created a prearranged off-setting trade with no economic risk, and no net change of beneficial ownership. Such actions have no legitimate business purpose and such behavior, standing alone, constitutes a per se violation of Market Behavior Rule 2(a). While NASUCA has made what appears to be, at first impression, a request for a minor modification to the Commission's definition of wash trades, to grant the requested modification would materially alter and detract from the clarity of our rule. To include trades of de minimis value in our definition of the term wash trade, under our rule, the Commission would be required to include trades that are not offsetting, that have a level of economic value and that result in a net change of beneficial ownership (however small). In addition, the Commission would be required to further define its views regarding what amount of value constituted a de minimis amount given the circumstances of the trade.

52. Further, in the Commission's view there is no need to modify this definition to include trades that involve de minimis values. While it is conceivable that a series of trades for de minimis amounts may be shown through evidence to constitute a scheme to manipulate the market, such action, while not a violation of the Commission's prohibition, would constitute a violation of the Commission's market manipulation standard under Market Behavior Rule 2.

53. The Commission also declines to limit its definition of wash trades to simultaneous trades that occur at the same delivery point. The Commission's definition provides that a wash trade is a pre-arranged off-

setting trade of the same product among the same parties, which involves no economic risk, and no net change in beneficial ownership. We have also recognized that such a transaction constitutes a per se violation of Market Behavior Rule 2(a). Pursuant to the Commission's definition, a wash trade must be pre-arranged but the offsetting portion of the trade may be executed at a separate time and/or delivery point. The Commission declines to adopt the suggested modification because this would permit parties to engage in activity that is currently prohibited by merely agreeing to execute the offsetting portion of the trade at a different place or time.

54. Puget Sound, et al. and Sempra Energy submit that if an exchange involving neither a change in price nor a transfer in beneficial ownership is entered into by a seller to avoid the need for transmission service, the exchange should not be regarded as a prohibited wash trade. We disagree with the intervenors' characterization of an exchange. In the Market Behavior Rules Order, we addressed a similar request for clarification made by EEI and found that because an exchange would either be at different prices, transfer beneficial ownership, or both, an exchange could not be characterized as a wash trade as we define it.

55. We will also deny the request sought by Merrill Lynch and Morgan Stanley that we limit our prohibition to wash trades occurring simultaneously or within seconds of each other. While most wash trades may, in fact, occur under these circumstances, this temporal element would ultimately be an irrelevant consideration as it relates to the market abuse we are attempting to prevent, where a pre-arranged offsetting trade otherwise qualifies as a wash trade under our rule. In fact, our rule will prohibit any such transac-

tion regardless of the timing sequence that may be utilized by the seller.

56. Finally, we decline to adopt at this time the proposed language currently pending before Congress which would, if adopted and signed into law, provide a statutory prohibition against wash trades. Our rule, which has been established pursuant to a regulatory process authorized under the FPA, stands on its own, based on a merits determination fully set forth in the Market Behavior Rules Order and reviewed here on rehearing.

E. Market Behavior Rule 2(b) (Prohibition Against Transactions Predicated on Submission of False Information)

Prohibited actions and transactions include, but are not limited to: (b) transactions predicated on submitting false information to transmission providers or other entities responsible for operation of the transmission grid (such as inaccurate load or generation data; or scheduling non-firm service for products sold as firm), unless Seller exercised due diligence to prevent such occurrences.

1. Requests for Rehearing and Clarification

57. Intervenors seek rehearing and clarification regarding the Commission's due diligence provisions as embodied in Market Behavior Rules 2(b), 2(c), and 3. The California Commission argues that a seller's implementation of these due diligence procedures should not operate as a defense for sellers regarding their employees' potential misconduct and that, in such a case, the state of mind of the seller's employ-

ees may be considered in adjudicating the seller's liability.

58. Sierra Southwest Cooperative Services, Inc. (Sierra Southwest) seeks clarification regarding the interplay between the intent standard embodied in the preamble requirement of Market Behavior Rule 2 and the due diligence standard set forth in subparts (b) and (c). Specifically, Sierra Southwest submits that predicating a seller's liability on its failure to exercise due diligence is the functional equivalent of a strict liability standard that cannot be reconciled with the intent requirement set forth in the Commission's preamble requirement.

59. Sempra requests clarification that the adoption of the procedures required by these due diligence provisions is intended to operate as a safe harbor for sellers in the form of a rebuttable presumption that the seller did not engage in conduct prohibited by Market Behavior Rules 2(b), 2(c), and 3. TDU Systems submits that the seller should be given the burden of proof to demonstrate that it had an adequate due diligence mechanism in place.

60. Cinergy and TDU Systems request clarification regarding the guidelines that will define for the industry the actions a seller needs to take to be in compliance with the Commission's due diligence standard. In addition, Cinergy requests clarification that a violation of the Commission's Market Behavior Rules by an employee of a seller will not constitute a prima facie case supporting a finding that the seller has failed to exercise due diligence. Cinergy asserts that absent these clarifications, the Commission's due diligence standard is unduly vague and unlawful.

61. Merrill Lynch and Morgan Stanley, as well as EEI, urge the Commission to utilize an intent standard in Market Behavior Rule 2(b). EEI asserts that this intent standard could be used in conjunction with the Commission's due diligence standard and asks the Commission to establish a workshop on an expedited basis to develop due diligence principles that could function as a safe harbor for sellers. EEI also notes that in evaluating due diligence immediately following the effective date of the Market Behavior Rules, a safe harbor transition allowance should be considered by the Commission.

62. EEI also seeks clarification that if a party provides information to a counterparty and then the counterparty alters the information, intentionally or inadvertently, the first party is not in violation of Market Behavior Rule 2(b). EEI also seeks clarification regarding the Commission's illustrative examples of prohibited transactions predicated on false information. EEI seeks clarification that use of non-firm transmission for a financially firm product where the seller of the financially firm product has agreed to make the buyer whole, if the transmission is cut, would not be a prohibited transaction predicated on false information.

63. Finally, Powerex Corp. (Powerex) requests clarification that Market Behavior Rule 2(b) contains a typographical error (with substantive implications) regarding the scheduling of non-firm service for products sold as firm. Specifically, Powerex asserts that the parenthetical clause "scheduling non-firm service or products as firm" should instead read "scheduling non-firm service for products as firm."

2. Commission Ruling

64. We will deny rehearing of the Market Behavior Rules Order relating to our adoption of Market Behavior Rule 2(b). However, we will also provide certain clarifications of our rule as it relates to the interplay between our intent requirement addressed in our market manipulation standard under Market Behavior Rule 2 and our due diligence allowance as set forth in the specific context of subpart (b) of our rule.[31]

65. Market Behavior Rule 2(b) prohibits transactions predicated on submitting false information to a transmission provider or other entities responsible for the operation of the transmission grid in the applicable market. In the Market Behavior Rules Order, we noted that the conduct addressed by this prohibition represented a specific form of market manipulation which cannot have a legitimate business purpose. We also acknowledged, however, that inadvertent or honest errors would be excused from our prohibition because the submission of false information under these circumstances would not meet the intent requirement as set forth in the main body of our rule, i.e., the seller, in this instance, would not have "intended to or foreseeably could [have] manipulate[d] market prices, market conditions, or market rules for electric energy or electricity products."

66. Unlike the occurrence of a wash trade, then, the submittal of false information to a transmission provider or other entities responsible for the operation of the transmission grid in the applicable market is not a per se violation of our Market Behavior Rules. Spe-

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[31] We will address separately, below, our due diligence standard as it relates to Market Behavior Rules 2(c) and 3.

cifically, a violation of Market Behavior Rule 2(b) cannot be based on the nature of conduct itself if a finding can be made that the submission at issue is attributable to an inadvertent or honest error.

67. We also addressed how this element of intent would be measured. We stated that we would not find a seller in violation of our rule in those cases where the seller can demonstrate that it has exercised due diligence to prevent the occurrence of the conduct at issue. We also stated, however, that we would examine the seller's conduct in relation to the procedures instituted by the seller to assure the sufficiency and accuracy of the submitted information. We stated that we would not treat as a defense to our rule, evidence that a given individual under the seller's direction or control did not personally know that the information it had submitted on the seller's behalf was false or incomplete. Conversely, where the seller can demonstrate that it has implemented procedures reasonably designed to comply with our rules, we will treat that evidence as a rebuttable presumption that the seller did not engage in the conduct prohibited by Market Behavior Rules 2(b), 2(c), and 3. Thus, we will grant Sempra's request for clarification relating to this issue.

68. The California Commission seeks rehearing regarding this due diligence standard, asserting that the procedures implemented by the seller should not operate as a defense to our rule. We will deny rehearing. The due diligence allowance adopted in our rule is an appropriate defense accorded to sellers accused of a violation of Market Behavior Rule 2(b), because the evidence it would bring before the Commission may be directly relevant to the issue of intent (an element of any subpart (b) violation). Specifically, where there

are procedures in place to assure the sufficiency and accuracy of the information submitted by the seller to a transmission provider or other entities responsible for the operation of the transmission grid in the applicable market, it may be found in a given case that the false submission at issue was in the nature of an inadvertent or honest error.[32]

69. However, we will grant the California Commission's request for clarification that the state of mind of the seller's employees may be permitted to be considered in adjudicating the seller's liability under Market Behavior Rule 2(b). While as a prima facie matter, the conduct of the seller alone may be relied upon by complainants, or the Commission, without reference to the state of mind of seller's employees or any other evidence, our due diligence standard is not intended to bar the consideration of evidence supporting the conclusion that the individual trader personally knew that the information at issue was false.[33]

70. Moreover, we will consider the defense of due diligence on a case-by-case basis utilizing the complaint

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[32] Thus, we will reject Sierra Southwest's suggestion that a finding made by the Commission that a seller has failed to exercise due diligence would impose a strict liability requirement that is inconsistent with our intent requirement under Market Behavior Rule 2. In fact, these requirements as they relate to Market Behavior Rule 2(b) are one and the same. Specifically, the absence of due diligence would support an inference of intent on the seller's part based on the facts and evidence presented.

[33] As such, we reject Cinergy's request for clarification that a violation of subpart (b) by an employee of a seller will not constitute a prima facie case supporting a violation of our rule. In fact, this evidence may be the only evidence available to a complainant at the time it is required to file its complaint.

procedures outlined by the Commission in the Market Behavior Rules Order. As such, we will deny those requests for rehearing seeking to establish additional a priori rules and guidelines involving rebuttable presumptions and burden and proof determinations. We also decline to prejudge or otherwise commit the Commission to any advance determinations regarding the existence or absence of due diligence in a given case.

71. We will also deny the clarification sought by EEI concerning the altering of information provided by a seller to a counterparty. If a seller provides information to a counterparty and then the counterparty alters the information, intentionally or inadvertently, the seller can only be held liable under our rule if the seller then submits this inaccurate information to the transmission provider or other entities responsible for operation of the transmission grid without exercising the requisite due diligence to confirm its accuracy.

72. However, we will grant EEI's requested clarification regarding the use of non-firm transmission for a financially firm product under certain conditions agreed to by the parties in their bilateral contract. We agree that where the parties' contract permits this scheduling allowance, such a practice would fall within the Commission-approved rules and regulations of an applicable power market and thus not be in violation of our rule.

73. Finally, we will grant the request made by Powerex and thus hereby clarify that the parenthetical clause "scheduling non-firm service or products as firm," as it appears in Market Behavior Rule 2(b), should read: "scheduling non-firm service for products as firm" (emphasis added).

F. Market Behavior Rule 2(c) (Prohibition Against Transactions Relating to the Creation of Artificial Congestion Followed by the "Relief" of Such Artificial Congestion)

Prohibited actions and transactions include, but are not limited to: (c) transactions in which an entity first creates artificial congestion and then purports to relieve such artificial congestion (unless Seller exercised due diligence to prevent such occurrence).

1. Requests for Rehearing and Clarification

74. Consumer Advocates assert as error the authorized scope of Market Behavior Rule 2(c), pointing out that market power can be exercised by sellers during all periods of congestion, regardless of whether this congestion is or is not caused by artificial means. Consumer Advocates note that Market Behavior Rule 2(c) fails to specify how a seller's market power will be constrained during all such periods of constraint. Consumer Advocates submit that the Commission's rule be reframed and broadened to address all levels of transmission congestion however it may be caused.

75. EEI and Puget Sound, et al. request clarification regarding the Commission's definition of artificial congestion as including "all forms of congestion that may result from scheduling power flows in an uneconomic manner for the purpose of creating congestion (real or perceived)."[34] EEI requests clarification that any activity found to have a "legitimate business pur-

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[34] See Market Behavior Rules Order, 105 FERC ¶ 61,218 at P 79.

pose," as that term is used in Market Behavior Rule 2, cannot be found to be "uneconomic" as that term is used the context of subpart 2(c) of this rule. Puget Sound, et al, argues that neither the term "artificial congestion" nor the term "scheduling power flows in an uneconomic manner" is defined with sufficient particularity.

76. In addition, Puget Sound, et al. question the workability of the Commission's due diligence standard as it applies in the case of congestion. Puget Sound, et al. assert that power flows and the creation of congestion will be affected by the activity of third party sellers and that, as such, no internal processes established by any single seller will be able to account for these occurrences. Accordingly, Puget Sound, et al. argue that Market Behavior Rule 2(c) should be revised to state explicitly that the creation of "artificial congestion" by a market participant must be intentional if it is to be prohibited.

77. Merrill Lynch and Morgan Stanley argue that to ensure that Market Behavior Rule 2(c) is not interpreted to mean that a seller is responsible for transactions in which any entity creates artificial congestion that the seller subsequently relieves, the Commission should substitute "Seller" for "an entity."

2. Commission Ruling

78. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 2(c). First, we reject Consumer Advocates' suggestion that our rule cannot achieve its stated objective. Our rule is designed to prohibit a specific form of market manipulation that first came to our attention in connection with the so-called Enron trading strategies in the Western markets. The

creation and relief of artificial congestion in these markets, we found, was a form of market abuse that in many cases was both significant and harmful.

79. At the same time, we have also acknowledged that the threat posed by this particular form of market manipulation may be a relatively limited one on a going forward basis. For example, it is unlikely to occur in an unorganized market where the transmission provider relies on Available Transmission Capacity assessments to schedule transmission. Nor should this form of market abuse occur in an organized market relying on Locational Marginal Pricing (LMP). Nonetheless, our prohibition serves as an important illustrative example of the type of market abuse our rule (Market Behavior Rule 2) is intended to prohibit, while continuing to serve a "real world" function in those organized markets that have yet to adopt an LMP system.

80. We will also reject Consumer Advocates' request that we broaden the scope of our rule to address congestion in all its forms, not just artificial congestion created by a seller whose intent is to manipulate the market. In fact, the thrust of Market Behavior Rule 2(c) is properly focused on market manipulation and purposeful conduct on the part of sellers that cannot have a legitimate business purpose. Accordingly, we will not address here, on an industry-wide basis, issues which can and already are being addressed by Commission-approved rules in individual markets.

81. However, we will grant the additional clarification requested by EEI and Puget Sound, et al. regarding our earlier clarification in the Market Behavior Rules Order that artificial congestion under our rule would be construed to include any form of congestion that

may result from scheduling power flows in an uneconomic manner for the purpose of creating real or perceived congestion. As requested, we clarify that a given scheduling strategy found to have a legitimate business purpose, as that term is used in Market Behavior Rule 2, cannot be found to have been the product of "uneconomic" conduct under subpart (c) of our rule. However, we note that Market Behavior Rule 2(c) contemplates a combined act involving, first, the creation of artificial or real congestion and then, second, an effort to relieve that congestion in exchange for a payment or compensation of some sort. Absent unexpected congestion which comes about in the dynamic operation of the power grid, we would not expect to discover many, if any, legitimate business purposes associated with such activity.

82. With respect to the operation and effect of our due diligence standard, in this context, we clarify that to rebut a prima facie case in which the seller's conduct alone and the facts and circumstances of the market as a whole are relied upon to infer intent, the seller may introduce evidence that the scheduling procedures it follows are reasonably designed to prohibit such conduct or render any conduct inadvertent.

83. Finally, we will grant the clarification requested by Merrill Lynch and Morgan Stanley concerning the reference in our rule to an "entity" that first creates artificial congestion and then purports to relieve such artificial congestion. We clarify that the "entity" to which this rule refers is the seller.

G. Market Behavior Rule 2(d) (Prohibition Against Certain Collusive Acts)

Prohibited actions and transactions include, but are not limited to: (d) collusion with another

party for the purpose of manipulating market prices, market conditions, or market rules for electric energy or electricity products.

1. Requests for Rehearing and Clarification

84. Consumer Advocates and NASUCA assert that Market Behavior Rule 2(d), which only prohibits overt collusion among parties for the purpose of manipulating market prices, fails to address market behaviors other than overt collusion which may also raise market prices above competitive levels. Consumer Advocates note that multilateral strategic bidding is one such example that may drive costs well above a competitive level. NASUCA adds that unintentional acts that are nonetheless within the control of the seller should also be prohibited under Market Behavior Rule 2(d).

85. Puget Sound, et al. argues that Market Behavior Rule 2(d) appears to add no prohibition that would not also be covered (and covered adequately) by the preamble requirement of Market Behavior Rule 2, i.e., that the preamble requirement would appear to cover proscribed activity involving one or more sellers. Puget Sound, et al. submit that if subpart (d) covers acts or transactions not covered by the preamble requirement, the Commission should specifically enumerate these prohibitions on rehearing.

86. Merrill Lynch and Morgan Stanley allege as error the Commission's failure to clarify the behavioral elements that may indicate collusion under either the FPA or the Natural Gas Act (NGA).[35] In addition,

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[35] 15 U.S.C. § 717, et seq. (2000).

Merrill Lynch and Morgan Stanley argue that Market Behavior Rule 2(d) fails to differentiate between actions that affect market prices and those that do not. Merrill Lynch and Morgan Stanley argue that if a seller's actions do not affect market prices to an extent that renders these prices unjust and unreasonable, the Commission has no statutory authority to impose any sanctions on the seller.

2. Commission Ruling

87. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 2(d). Specifically, we will deny the requests made by Consumer Advocates and NASUCA to include within the scope of Market Behavior Rule 2(d) manipulative conduct other than overt collusion. In fact, the market abuses contemplated by Consumer Advocates and NASUCA will be addressed by our Market Behavior Rules to the extent these abuses are without a legitimate business purpose and are intended to or foreseeably could manipulate market prices, market conditions, or market rules for electric energy or electricity products.

88. We will also deny Puget Sound, et al's request that we reject Market Behavior Rule 2(d) as redundant given the preamble requirement of Market Behavior Rule 2. While Puget Sound, et al. is correct in its analysis that a violation of Market Behavior Rule 2(d) would also constitute a violation of our preamble requirement (our antimanipulation standard), the interplay between this preamble requirement and each of the four subparts of our rule is by design. The preamble requirement, as noted above, is constructed in such a way that it can apply to conduct whose specific form and nature may not be known today. The

subparts of our rule, by contrast, are intended to apply to specific forms of conduct - in the case of Market Behavior Rule 2(d), to collusion.

89. We will also deny the requests for rehearing submitted by Merrill Lynch and Morgan Stanley. First, we disagree that Market Behavior Rule 2(d) fails to specify with sufficient particularity the behavioral elements that may be found to constitute collusion in a given case. For the reasons noted above with respect to the preamble requirement of Market Behavior Rule 2, we believe that sellers have been given adequate notice of the behavior prohibited by our rule. Moreover, for the reasons noted above, we decline to add greater specificity to a standard that will and must be relied upon in the future to prohibit manipulative acts or transactions whose precise form and nature cannot be envisioned today.

90. Finally, we decline to limit our prohibition to acts which may affect market prices. In fact, for the reasons noted in the Market Behavior Rules Order, our rule appropriately extends to the manipulation of market conditions and market rules, in addition to a seller's interference with market prices. Contrary to the assertions advanced by Merrill Lynch and Morgan Stanley, the Commission is fully authorized under the FPA to regulate market conditions and market rules applicable to the wholesale electricity markets in which market-based rate sellers conduct their business.

H. Market Behavior Rule 3 (Communications)

Seller will provide accurate and factual information and not submit false or misleading information, or omit material information, in any com-

munication with the Commission, Commission-approved market monitors, Commission-approved regional transmission organizations, or Commission-approved independent system operators, or jurisdictional transmission providers, unless Seller exercised due diligence to prevent such occurrences.

1. **Requests for Rehearing and Clarification**

91. EPSA requests clarification regarding the Commission's statement in the Market Behavior Rules Order that a jurisdictional entity requesting or receiving information covered by Market Behavior Rule 3 must be authorized to do so pursuant to its Commission-approved tariff or other Commission-approved authorizations. EPSA requests that the language of Market Behavior Rule 3 be modified to reflect this understanding.

92. Puget Sound, et al. argue that the requirement that sellers not omit material information in any communication covered by Market Behavior Rule 3 is vague and overbroad to the extent it may require sellers, in response to a Commission data request, to interpret the scope of the data request in a way that comports with the Commission's interpretation. Puget Sound, et al. requests that the Commission delete this requirement from Market Behavior Rule 3.

93. Merrill Lynch and Morgan Stanley and Mirant and Williams request clarification that Market Behavior Rule 3 prohibits market participants from knowingly submitting "false and misleading" information. Merrill Lynch and Morgan Stanley assert that in addition to this requirement, the Commission's rule should further specify that the information submitted be mis-

leading on an issue that is material to the subject of the communication or submission and creates an artificial price. Merrill Lynch and Morgan Stanley also request revision of Market Behavior Rule 3 (as well as Market Behavior Rule 4) to specify expressly that sellers will not be found to have violated the Commission's rules for omissions that may occur due to a legal requirement to protect confidential information.

2. Commission Ruling

94. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 3. First, we reject EPSA's request that we modify our rule to apply only if the information at issue is requested or received pursuant to a Commission-approved tariff or other Commission-approved authorization. This clarification is unnecessary in those cases where the seller objects to the request on the grounds that the entity at issue does not have the authority to seek the information requested. In these circumstances, the seller can assert this defense without the clarification sought by EPSA. If, on the other hand, the seller voluntarily provides this information or complies with a Commission-authorized request to do so, Market Behavior Rule 3 should and will apply.

95. We will also reject the request for rehearing submitted by Puget Sound, et al. regarding the alleged vagueness of the requirement that sellers not "omit material information." While the term "material," in this context, may not be given to a precise before-the-fact definition in every case, we believe the seller will have sufficient notice regarding the requirements of our rule. First, materiality can be established with sufficient particularity by the seller by reference to

Commission-approved rules and industry practices. In addition, sellers will also be accorded a safe harbor under our rule to allow for reasonable, unforeseen differences regarding the meaning of our requirement as it may be applied, i.e., our rule will not be applied against a seller shown to have exercised due diligence.

96. Finally, we will deny rehearing regarding the sufficiency of our due diligence allowance. Rehearing applicants urge that this due diligence standard be further strengthened (or simply replaced) by an express intent requirement and/or by similar qualifications that would have the effect of limiting the application of our rule in the case of certain false or misleading communications. In addition, Merrill Lynch and Morgan Stanley argue that a seller's omission of material information be excused in those circumstances where the omission is attributable to a legal requirement to protect confidential information. While we agree that a false or misleading communication (or omission of relevant information) may, in a given case, be excusable based on the facts and circumstances presented, we are not convinced that our due diligence standard would be inadequate for the purpose of considering such a defense. To the contrary, we believe that a due diligence defense will give sellers sufficient latitude to bring all relevant facts on this issue before the Commission in advance of any action which may be taken against the seller.

I. **Market Behavior Rule 4 (Reporting)**

To the extent Seller engages in reporting of transactions to publishers of electricity or natural gas price indices, Seller shall provide accurate and factual information, and not knowingly

submit false or misleading information or omit material information to any such publisher, by reporting its transactions in a manner consistent with the procedures set forth in the Policy Statement issued by the Commission in Docket No. PL03-3 and any clarifications thereto. Seller shall notify the Commission within 15 days of the effective date of this tariff provision of whether it engages in such reporting of its transactions and update the Commission within 15 days of any subsequent change to its transaction reporting status. In addition, Seller shall adhere to such other standards and requirements for price reporting as the Commission may order.

1. **Requests for Rehearing and Clarification**

97. TDU Systems alleges as error the Commission's failure to make its reporting requirement mandatory. TDU Systems argues that mandatory reporting is critical to maintaining the integrity of published price indices.

98. EEI and Duke request clarification regarding the Commission's adoption of a safe harbor standard for good faith reporting of transaction data to reporting agencies, concerning specifically the requirement that, in connection with this safe harbor allowance, each data provider "adopt and make public a clear code of conduct that its employees will follow in buying and selling natural gas or electricity and in reporting data from such transactions to index develop-

ers."[36] EEI and Duke request clarification that the provisions to be made public under this rule include only those provisions dealing with sellers' price reporting procedures, i.e., to those provisions addressing employee guidelines in reporting data from electricity and natural gas transactions to reporting agencies.

99. Merrill Lynch and Morgan Stanley request clarification regarding a seller's reporting obligations in those circumstances where the seller may be reporting trade data, at the request of an index publisher, for some but not all of its hubs, i.e., where not all of the seller's hubs are part of the index. Merrill Lynch and Morgan Stanley request clarification that in this case, the Commission's safe harbor provisions will apply as to the hubs covered by the seller's reporting.

100. Finally, NASUCA challenges the Commission's safe harbor allowance, arguing that inadvertent errors should not be permitted to shield sellers from their obligations to provide just and reasonable rates to consumers.

2. Commission Ruling

101. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 4. First, we will deny the request for rehearing submitted by TDU Systems with respect to the issue of voluntary versus mandatory reporting. In our Price Reporting Policy Statement, we discussed at length why a mandatory reporting requirement would

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[36] See Price Discovery in Natural Gas and Electric Markets, 104 FERC ¶ 61,121 at P 5, as clarified, 105 FERC ¶ 61,282 (2003) (Price Reporting Policy Statement).

not be appropriate at this time, based, in part, on our reliance on a safe harbor allowance to induce voluntary reporting and based further on our need to actively monitor and assess the still-evolving approaches to price reporting now being actively considered by both price index developers and data providers.[37] Accordingly, we will not consider a mandatory reporting requirement in this proceeding. If further reporting requirements are developed, however, the seller's compliance with these requirements will be required under Market Behavior Rule 4.

102. We will also deny the request for clarification submitted by EEI and Duke concerning our requirement that, in connection with our safe harbor allowance, sellers will be required to adopt and make public a code of conduct to be followed by the sellers' employees in buying or selling natural gas or electricity and in reporting data from such transactions to index developers. While this requirement was set forth by the Commission in our Price Reporting Policy Statement, not in the Market Behavior Rules Order, we note here that the requirement clearly and unambiguously applies to employee guidelines relating to "buying or selling natural gas or electricity" (not just to personnel guidelines relating to the actual reporting function, as EEI and Duke urge). The scope of this requirement is appropriate, moreover, for all the reasons discussed in our Price Reporting Policy Statement, including the need for assurance that a seller's

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[37] The Commission and the industry itself is still actively considering the policy options relating to this issue. On March 5, 2004, for example, the Commission's Staff issued a notice in Docket Nos. PL03-3-000 and AD03-7-000 soliciting comment on the current state of natural gas and electricity price formation.

trading activities be kept separate from its reporting functions.

103. We will also deny the request for rehearing submitted by Merrill Lynch and Morgan Stanley concerning our requirement that a seller who chooses to report any of its transactions to a price index developer will be required to report all of its transactions, including platform-facilitated transactions, to at least one index developer. This requirement, we have indicated, is made necessary in order to improve the accuracy, reliability, and transparency of price formation and is a condition to our safe harbor allowance.

104. Finally, we will deny rehearing regarding our adoption of our safe harbor allowance. For all the reasons discussed in our Price Reporting Policy Statement, this safe harbor has been adopted in order to encourage voluntary reporting. In the event our rule achieves that purpose, moreover, it will not invite market abuse nor will it allow market abuses to go undetected. To the contrary, our safe harbor allowance will serve as a rebuttable presumption only and will not shield or protect the intentional submission of false, incomplete or misleading information to index developers.

J. Market Behavior Rule 5 (Record Retention)

Seller shall retain, for a period of three years, all data and information upon which it billed the prices it charged for electric energy or electric energy products it sold pursuant to this tariff or the prices it reported for use in price indices.

1. Requests for Rehearing and Clarification

105. APPA and TAPS allege as error the Commission's failure to require sellers to retain the information and data that may be required to implement the grant of a disgorgement remedy in a given case. APPA and TAPS urge the Commission to revise Market Behavior Rule 5 to include the retention of all data and information relating to the seller's revenues and expenses.

106. EPSA and Puget Sound, et al. request clarification regarding the Commission's statement in the Market Behavior Rules Order that Market Behavior Rule 5 will not require sellers to retain cost of service or analytical data to reconstruct all sales made by the seller. EPSA requests that Market Behavior Rule 5 be revised to reflect this clarification expressly. Puget Sound, et al. request that the Commission further clarify that its data retention requirement includes only primary records used by the seller to bill its counterparties, including "confirms," metering data, and settlement documents, and does not extend to secondary records, including e-mails and internal memoranda that are not used for billing purposes.

107. Merrill Lynch and Morgan Stanley argue that Market Behavior Rule 5 should be revised to include an express reliance component, such that documents would be retained by sellers only to the extent that they were actually relied on by the seller to bill a counterparty for the energy sold.

2. Commission Ruling

108. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 5, our record retention rule. First, we

reject rehearing applicants' argument that our rule requires further clarification or revision in order to implement the grant of an effective disgorgement remedy in a given case. Specifically, we do not believe that the retention of all data and information relating to the seller's revenues and expenses is necessary in order to deter the market abuses addressed by our rules or to provide an appropriate remedy in the event these rules are violated.

109. We also decline to clarify our rule further with the addition of such distinctions as primary versus secondary records and documents which may or may not have been expressly relied upon by the seller. Our rule requires sellers to retain all contractual and related documentation supporting the seller's billing statements (or its reported prices) relating to its market-based rate sales. If a given record includes information that fits this description, it must be retained for a period of three years, regardless of the medium in which the record is maintained (whether a contractual document, email, or other record). Accordingly, we need not make any additional distinctions between the innumerable forms in which these records could be classified or kept (e.g., primary versus secondary documents), or the extent to which the seller may have expressly relied on these records.

K. Market Behavior Rule 6 (Related Tariff Matters)

Seller shall not violate or collude with another party in actions that violate Seller's market-based rate code of conduct or Order No. 889 standards of conduct, as they may be revised from time to time.

1. Requests for Rehearing and Clarification

110. APPA and TAPS allege as error the Commission's exclusion from its rule of certain standards of conduct other than an Order No. 889 standard of conduct. APPA and TAPS note that there may be Commission-approved standards of conduct other than those approved pursuant to Order No. 889 and that these standards should also be included within the reach of Market Behavior Rule 6.

111. Merrill Lynch and Morgan Stanley note that Order No. 889 does not apply to a power marketer that is not affiliated with a transmission provider and therefore request clarification that Market Behavior Rule 6 does not impose on non-affiliated power marketers a requirement to comply with Order No. 889. In addition, Merrill Lynch and Morgan Stanley assert that non-affiliated power marketers should not be required to include this rule in their market-based rate tariffs.

2. Commission Ruling

112. We will deny rehearing of the Market Behavior Rules Order as it relates to our adoption of Market Behavior Rule 6. Our rule simply clarifies that sellers' conduct in the wholesale electricity markets in which they do business must be consistent with (and fully adhere to) the seller's electric power sales code of conduct, as set forth in seller's market-based rate tariff or rate schedule, as well as seller's Order No. 889 standards of conduct. As such, the concern expressed by APPA and TAPS that there may be additional Commission-approved codes of conduct to which the seller may also be subject is beyond the scope of our rule. To the extent that remedies and procedures may need to be clarified, in the future, with respect to any

such additional tariff requirements, we will provide the appropriate forum for interested parties to have their views heard on such matters.[38]

113. In addition, we need not enumerate in the language of our rule the entities for whom this rule may not apply in a given case, including power marketers that may not be subject to Order No. 889. If a seller is not subject to Order No. 889, it will not be subject to our rule as it relates to a standards of conduct requirement issued pursuant to that order.

L. Market Behavior Rules and Other Requirements Not Adopted By the Commission in the Market Behavior Rules Order

The Market Behavior Rules Order declined to adopt various rules proposed by intervenors as an alternative to our Market Behavior Rules, including new rules designed to address transmission congestion, market power, and the overall competitiveness of the wholesale electricity market. We noted that while these structural issues represent a critical element of a competitive market, and would continued to be pursued by the Commission in the appropriate proceeding, including proceedings currently pending before the Commission, the potential for market abuse (and thus the need for our Market Behavior

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[38] See, e.g., Order No. 2004, 68 Fed. Reg. 69, 134 (Dec. 11, 2003), III FERC Stats. & Regs. ¶ 31,155 (Nov. 25, 2003), order on reh'g, Order No. 2004-A, 107 FERC ¶ 61,032 (2004). We also note that Market Behavior Rule 1 would be applicable to any Commission-approved standards of conduct that are not otherwise addressed by Market Behavior Rule 6.

Rules) will continue to exist even in a structurally competitive market.

1. Requests for Rehearing and Clarification

114. APPA and TAPS assert that in not adopting a more comprehensive set of rules and regulations applicable to the marketplace as a whole, in addition to (or in lieu of) our Market Behavior Rules, the Market Behavior Rules Order erred. The Consumer Advocates also challenge the scope of the Commission's undertaking in this proceeding, asserting that the assumption on which the Commission's Market Behavior Rules stand, i.e., that market-based rates can be just and reasonable, must be rejected on legal grounds as inconsistent with the FPA.

115. Other intervenors assert that the Commission erred in the Market Behavior Rules Order by not addressing various other issues. APPA and TAPS allege that the Commission erred by not requiring greater transparency with respect to market information and data and by not requiring that the information which currently is made available in ISO/RTO markets be made available on a real-time or next-day basis. Merrill Lynch and Morgan Stanley allege as error the Commission's failure to apply its Market Behavior Rules to market operators and LSEs.

116. In addition, the California Commission alleges as error the Commission's failure to expressly prohibit hockey stick bidding as one of its subparts to Market Behavior Rule 2, i.e., a bidding pattern where the last megawatt bid from a unit is made at an excessively high price relative to other bids attributable to the unit, or where a single unit in a portfolio is bid at an

excessively high level compared to the remainder of the seller's portfolio.

117. Finally, Consumer Advocates and NASUCA allege as error the Commission's determination to reject proposed subpart (e) of Market Behavior Rule 2.[39] Consumer Advocates argue that this manipulation standard was appropriate because it would have addressed strategic bidding behavior as well as economic withholding in the wholesale bilateral contract markets. NASUCA asserts that the proposed rule was not redundant with Market Behavior Rule 1, which may not apply to economic withholding.

2. Commission Ruling

118. We will deny rehearing of the Market Behavior Rules Order with respect to those issues not addressed or adopted by our order. First, for the reasons cited in the Market Behavior Rules Order,[40] we decline to address in the context of this proceeding, where our focus is on seller conduct relative to the industry as a whole, issues related to the structure and operation of specific markets, including the duties and functions performed in these markets by RTOs, ISOs, other transmission providers, LSEs, or by market participants. As such, we deny the rehearing requests made with respect to these issues by APPA

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[39] As proposed in the June 26 Order, Market Behavior Rule 2(e) would have prohibited sellers from "bidding the output of or misrepresenting the operational capabilities generation facilities in a manner which raises market prices by withholding available supply from the market."

[40] See Market Behavior Rules Order, 105 FERC ¶ 61,218 at PP 137-38.

and TAPS, Consumer Advocates, and Merrill Lynch and Morgan Stanley.

119. We will also deny the request made by the California Commission to include, as an express form of market manipulation under the subparts of Market Behavior Rule 2, the practice of hockey-stick bidding. Rules relating to specific bidding behaviors within organized markets with a prescribed bidding regime should be considered as a component of the particular rules and requirements of that power market. The rules and requirements associated with such a regime are particular to these markets and should be clearly established in the tariff governing that market.[41] Such market issues are not properly addressed in these rules of general applicability.

120. Finally, we will deny the requests for rehearing submitted by Consumer Advocates and NASUCA regarding our determination in the Market Behavior Rules Order to reject subpart (e) of Market Behavior Rule 2, as proposed in the June 26 Order. For the reasons cited in the Market Behaviors Rule Order,[42] proposed subpart (e) of Market Behavior Rule 2 addressed biding into organized markets in violation of the Commission-approved rules applicable in these markets. As such, the proposed rule was redundant with Market Behavior Rule 1. Moreover, to the extent Consumer Advocates and NASUCA may have interpreted proposed subpart (e) as applying in a broader context not encompassed by a Commission-approved

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[41] For example, the bidding regime within CAISO's market will be addressed in the pending CAISO market redesign proceeding in Docket No. ER02-1656.

[42] Id. at PP 99-102.

rule or regulation of the applicable power market (i.e., not encompassed by Market Behavior Rule 1), manipulative conduct, in this context (including economic withholding and strategic bidding behavior) could still be actionable in a given case under the general manipulation standard set forth in Market Behavior Rule 2.

M. Remedies

In the Market Behavior Rules Order, we found that any violation of our Market Behavior Rules will constitute a tariff violation. We also held that in connection with any such violation, seller would be subject to disgorgement of unjust profits associated with the tariff violation, from the date on which the tariff violation occurred. In addition, we held that seller may also be subject to suspension or revocation of its authority to sell at market-based rates or to other appropriate non-monetary remedies.

1. Requests for Rehearing and Clarification

121. Rehearing applicants seek to either narrow the range of remedies available in connection with a seller's violation of our Market Behavior Rules or, conversely, seek to expand these available remedies. With respect to those rehearing applicants seeking to limit these remedies, Duke asserts that reliance on a disgorgement remedy will harm rather than advance the Commission's goal of robust competitive markets and, in addition, will defeat the Commission's stated goal of promoting transaction finality.

122. Duke also seeks clarification that to the extent its rehearing request on this issue is denied, the Commission, in exercising its discretion to order refunds for

behaviors not specifically prohibited by our rules, will place significant weight on the degree to which the violation is self-evident. In addition, Duke seeks clarification that refunds, if ordered, will be limited to those portions of transactions within the applicable quarter in which the Commission makes a finding of a conduct violation, such that if the Commission finds that a conduct violation occurred during one hour of a daily transaction, refunds would be limited to that single hour.

123. In addition, EEI requests clarification that in the case of a technical rule violation that may not warrant disgorgement of profits or other serious penalties, the Commission will take a reasonable approach when determining whether a complaint is worth pursuing and in determining a fair and equitable remedy. Puget Sound, et al. request clarification that a violation of the Commission's rules by an individual seller in a single price auction market will not give rise to an obligation on the part of all sellers in that market to reprice their transactions.

124. Other rehearing applicants allege as error the Commission's failure to impose a broader monetary liability on sellers found to have violated the Commission's Market Behavior Rules. The Cal Oversight Board, NASUCA and TDU Systems, for example, argue that sellers should be required to make the market whole in these circumstances because a more narrowly tailored disgorgement remedy (focusing only on the transaction to which the seller's violation may be attributable) will fail to provide an adequate deterrent to improper behavior.

125. APPA and TAPS also allege as error the Commission's conclusion in the Market Behavior Rules Order

that disgorgement of unjust profits and the possible revocation of a seller's market-based rate authority will suffice to induce compliance with the Commission's Market Behavior Rules. APPA and TAPS argue, to the contrary, that the upside potential of profitable manipulation outweighs the costs associated with the Commission's remedies. Consequently, APPA and TAPS recommend that in the case of a Market Behavior Rule violation, a seller should be required to disgorge all profits realized by both the seller and its affiliate in connection with the violation and that this disgorgement requirement not be limited to the specific transactions through which the manipulation occurred. In addition, APPA and TAPS propose that a seller be subject to penalties that represent multiples of its ill-gotten profits, similar to those approved by the Commission with respect to over-scheduling.[43] APPA and TAPS further argue that the proceeds from these remedies should be directed to those consumers who paid higher prices as a result of the abuse.

126. The California Commission alleges that the Commission failed to adequately explain the basis for its determination that a disgorgement remedy in lieu of any other monetary remedies should be regarded as appropriate. In addition, the California Commission argues that the Commission's limitation of remedies unlawfully conflicts with the FPA because it unreasonably fails to protect consumers and diverges, without explanation, from the Commission's general policy of providing refunds.

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[43] See APPA and TAPS request for rehearing at 20, citing Allegheny Power Corp., et al., 80 FERC ¶ 61,143 at 61,545 (1997) (order approving buyer penalty for taking more service than reserved equal to the applicable rate plus 100 percent).

127. Finally, Sempra requests clarification that the Commission's behavioral rules, as applied, will not narrow the protections afforded to contracting parties under the Mobile-Sierra public interest standard of review[44] (where the contracting parties have chosen to rely on such protection) and thus will not serve as grounds for contract modification, absent a finding that the contract is the direct result of the alleged violation and that engaging in the alleged violation directly affects the fairness and good faith of the parties at the contract formation stage.

2. Commission Ruling

128. We will deny rehearing regarding our determinations in the Market Behavior Rules Order with respect to the appropriate remedies that should be made available to market participants in connection with a seller's violation of our Market Behavior Rules. In making these determinations, we appropriately balanced the need of a seller for regulatory certainty (and transaction finality) with the needs of the Commission, in the fulfillment of its statutory duties, to ensure compliance with our rules and the needs of market participants to have an appropriate remedy in the case of a loss attributable to the seller.

129. Thus, we held that a remedy limited to a disgorgement of the seller's unjust profits would be an appropriate remedy.[45] First, we noted that this remedy

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[44] See United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956) and Federal Power Commission v. Sierra Pacific Co., 350 U.S. 348 (1956).

[45] See, e.g, Coastal Oil & Gas Corp. v. FERC, 782 F.2d 1249 (1986) (revenues collected through a seller's market manipula-

(*Footnote continued*)

would not constitute a retroactive refund because our Market Behavior Rules establish clear advance guidelines to govern market participant conduct. Moreover, we found that in approving these Market Behavior Rules and requiring sellers to be fully accountable for any unjust gains attributable to their violation, we would not foreclose our reliance on existing procedures or other remedial tools, as may be necessary, including generic rule changes or the approval of new market rules applicable to specific markets.[46]

130. We also rejected commenters' assertions that a disgorgement remedy may be difficult to calculate in a particular case, or may operate as a chill on the market in other circumstances. The concerns raised by commenters, we noted, are speculative at best. Moreover, we stated that any such concerns can be fairly evaluated by the Commission on a case-by-case basis, with a full opportunity for input from all interested parties. Thus, we found that we need not reject a disgorgement remedy in all cases simply because it may be inappropriate to apply (and need not be imposed) in a specific case.

131. We also rejected commenters' assertions that, in enforcing our Market Behavior Rules, the Commis-

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tion in excess of a just and reasonable rate may be subject to disgorgement).

[46] If Congress grants the Commission additional remedial power, including the authority to levy civil penalties, the Commission will, in addition to the remedies set forth herein, implement such authority and utilize it when appropriate for violations of these Market Behavior Rules. We strongly endorse Congressional legislation that would provide the Commission with additional civil penalty authority for violations of our orders, rules and regulations.

sion should consider a make-the-market-whole remedy. We noted that the remedies we were adopting included the possible revocation of Sellers' market-based rate authority. We found that these remedies would provide a sufficient inducement for sellers to comply with our rules.

132. On rehearing, we decline to modify or otherwise rescind these determinations. Specifically, we will not lessen on a categorical basis, as proposed, the potential consequence for a rule violation, as advocated by Duke, EEI, and Puget Sound, et al., nor will we subject the seller to the possibility of stiffer penalties, as proposed by the Cal Oversight Board, NASUCA, TDU Systems, the California Commission, and APPA and TAPS. In fact, the remedies we adopted in the Market Behavior Rules Order strike a careful balance between these respective interests. Moreover, we reject Duke's renewed assertion that these remedies will cast a chill on the industry. To the contrary, we found in the Market Behavior Rules Order and reiterate, here, that our Market Behavior Rules and the remedies we have specified in the case of violations will foster greater consumer confidence in the operation of the wholesale market, promote competition, and assist the Commission in the performance of its statutory duties.

133. We will also deny Duke's request that we limit refunds in the case of a rules violation to the quarterly period in which the violation is found to have occurred. While we are mindful of the seller's need for transaction finality, as a general proposition, the balance of interests in this particular context may require us to extend our disgorgement remedy to the entirety of the seller's improperly-obtained revenues, i.e., to

those revenues found to be in excess of those that would have been garnered absent manipulation.

134. However, we will grant the clarification sought by Duke regarding the discretion that will be exercised by the Commission in enforcing its rules. In exercising its discretion to determine the appropriate remedy for the violation of our rules, we will take into account factors such as how self evident the violation is and whether such violation is part of a pattern of manipulative behavior in considering the facts and circumstances of the case.

135. Finally, we will grant, in part, the clarification sought by Sempra. Our Market Behavior Rules are not intended to narrow the protections afforded to a contracting party under the Mobile-Sierra public interest standard of review in the case of a proposed contract revision.

N. **Complaint Procedures**

Complaints alleging any violation of the Commission's Market Behavior Rules will be subject to the remedies and procedures set forth in Appendix B to the Market Behavior Rules Order. The Appendix B procedures specify, among other things, that complaints seeking relief for a market behavior rule violation shall be made no later than 90 days after the end of the calendar quarter in which the violation is alleged to have occurred. In addition, Appendix B specifies that the Commission will act within 90 days from the date it knew of an alleged violation or knew of the potentially manipulative character of an action or transaction.

1. Requests for Rehearing and Clarification

136. TDU Systems, the Cal Oversight Board, and APPA and TAPS allege as error the Commission's determination in the Market Behavior Rules Order to impose a 90-day deadline for complaints seeking, as a remedy, disgorgement of unjust profits. TDU Systems and APPA and TAPS assert that, at a minimum, this time allowance should be extended to 180 days. The Cal Oversight Board proposes that the Commission's limitation period be revised to one-year from the date the complainant knew or, upon the exercise of due diligence, should have known of the wrongful conduct, but no later than two years after the date of the transaction.

137. The California Commission argues that imposing complaint limitations periods frustrates the purpose of the FPA and subjugates the pubic interest to private suppliers. The California Commission further asserts that while the remoteness of an alleged violation can and should be considered in determining the scope of relief, a limitations period cannot be relied upon to defeat the right of market participants to a just and reasonable rate and the enforcement of a filed rate. The California Commission also takes issue with the Commission's requirement that it will act within 90 days from the date it knew of an alleged violation of its Market Behavior Rules or knew of the potentially manipulative character of an action or transaction. The California Commission submits that this requirement is impermissibly vague because there is no indication regarding how specific the allegation must be in order to constitute knowledge. The California Commission suggests that in order to constitute "knowledge," the allegation should be communi-

cated in writing with sufficient specificity to identify the participants, transactions and dates of the alleged behavior. The California Commission also requests clarification that when the Commission initiates an investigation under its Market Behavior Rules on its own, it will do so in a public manner that affords buyers and state regulatory authorities access to information and an opportunity to be heard.

138. EEI, Duke, Puget Sound, et al., Cinergy, Sempra, Merrill Lynch and Morgan Stanley, and Mirant and Wiliams also seek rehearing of the Commission's complaint procedures, arguing that these procedures will impose an undue hardship on sellers, absent the various revisions and/or clarifications these intervenors seek. Sempra argues that the Commission's 90-day complaint deadline should be applied without exception. EEI, on the other hand, supports the Commission's "should not have known" allowance applicable to market participant complaints, but argues that this exception to the 90-day rule should be subject to a reasonable time limit and require a showing of actual harm to the complainant. Puget Sound, et al. requests clarification that any complaint filed after the 90-day period carry a heavy burden in demonstrating that the complainant could not have known of the violation within the 90-day period.

139. Cinergy alleges as error the Commission's failure to include assurances that a complainant bears the burden of proof to come forth with specific facts and allegations that present a prima facie case before any such proceeding will be instituted against a seller.[47]

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[47] Duke seeks clarification regarding this same issue, arguing that complaint alleging a market behavior rule violation should

(*Footnote continued*)

Merrill Lynch and Morgan Stanley suggest that complainants be required to specifically state in their complaint the transactions that allegedly violate the Commission's rules and quantify that alleged harm attributed to the violation. Cinergy also requests clarification that an expedited procedure will be utilized to allow the Commission to act definitively and with dispatch on a complaint, so that disruption and harm to both the market and the market participant can be minimized.

140. Duke asserts that the period for refunds from all investigations, through formal complaints or Commission actions initiated by communications from persons that could have filed a complaint, should be measured on the same basis, i.e., that such communications must occur within 90 days of the end of the calendar quarter to preserve retroactive refunds as a penalty. In addition, Duke recommends that the Commission adopt a date certain, one year after the end of the applicable calendar quarter, after which no refunds will be ordered. Duke also urges the Commission to include within its procedures a requirement to promptly inform the seller of the initiation of an investigation.

141. Duke also requests clarification regarding the mechanisms that will be utilized by the Commission to clarify the specific application of its Market Behavior Rules on a going-forward basis. Duke asserts that given the significant market uncertainty engendered

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be adjudicated in accordance with the Commission's existing complaint procedures, including the requirement that a complainant make out a prima facie case as a pre-condition to Commission action on the complaint.

by the Commission's Market Behavior Rules, the Commission should establish a formal mechanism for market participants to obtain prompt guidance on specific activities or situations identified over time, including but not limited to staff opinion letters, technical conferences, and streamlined procedures to seek declaratory rulings.

142. EEI and EPSA seek clarification that the Commission will not allow complainants to bypass time limits by making anonymous complaints, either through the hotline or by other means. EPSA requests that the Commission direct its staff to ensure that any allegations of market behavior violations made through the Hotline or informal communications be subject to a due diligence process to determine whether the complaint was made in a timely and acceptable manner. Mirant and Williams assert that the Commission should not initiate an action at the behest of a market participant or other interested party who failed to initiate a complaint proceeding or otherwise failed to take steps to inform the Commission of an alleged violation within the prescribed time period.

143. EEI also requests clarification that the Commission will only take prospective action against a seller in those circumstances where the Commission's knowledge of a violation has been acquired by an entity that "should have known" of the violation within the 90-day rule. EEI and Mirant and Williams also asserts that any type of communication with the Commission (including communications made by market monitors), not just communications with enforcement Staff, should constitute knowledge on the Commission's part for purposes of triggering the Commission's 90-day complaint limitation period. Mirant and

Williams propose to further extend this imputed knowledge limitation to "any other means by which the Commission or Commission Staff receives or generates information reasonably suggesting that a violation has occurred."

144. In addition, Mirant and Williams propose that to the extent such information is provided to the Commission or to enforcement Staff by a potential third party complainant, no action should be permitted by the Commission unless this information was provided to the Commission or to enforcement Staff within the time period proscribed for complaints.

145. Finally, the California Commission, the Cal Oversight Board, the New England Conference of Public Utilities Commissioners, the Vermont Department of Public Service, and the Michigan Public Service Commission (NECPUC, et al.), and the Sacramento Municipal Utility District (SMUD) request special exemptions with respect to our complaint limitations period as it would apply to governmental entities and/or non-market participants.

2. Commission Ruling

146. We will deny rehearing of the Market Behavior Rules Order as it relates to our Appendix B complaint procedures. Specifically, we decline to modify our 90-day time limitation on complaints or our specified exceptions to this limitations period. These complaint procedures strike a reasonable balance between the interests of sellers and the market as a whole, for all the reasons noted in the Market Behavior Rules Order.

147. While the Commission has acknowledged the importance of rate certainty in the form of transaction

finality, the need for rate certainty must, in this instance, be balanced against the fact that many market abuses are not immediately apparent and market participants may need time to discover and verify that abuses have occurred. Our complaint limitation procedures provide this necessary balance to protect the interests of sellers, on the one hand, and those who may have been adversely affected by violations of our Market Behavior Rules that may not be readily apparent. As we recognized in the Market Behavior Rules Order, our complaint limitation procedures have been designed to provide a reasonable balance between encouraging due diligence in protecting one's rights and finality in transactions.

148. Our Appendix B allowance that the 90-day time-limit will be deemed to have run after 90-days of an alleged act unless the "complainant can show that it did not know and should not have known of the behavior which forms the basis for its complaint" is an important part of the balance reached by the Commission. This language ensures that a reasonable person exercising due diligence will have sufficient time to discover hidden wrongful conduct and to submit a claim within an appropriate timeframe. The party initiating a complaint after this time limit has run will be required to make an adequate showing to convince the Commission that it could not have known of the alleged violation during the 90-day period following the calendar quarter in which the violation occurred.

149. The Commission, unlike the market participants who may be buyers or otherwise directly affected by a transaction, may not be aware of actions or transactions that potentially may violate our rules. Therefore, the Commission will act within 90 days from the date it knew of an alleged violation of its Market Behavior

Rules or knew of the potentially manipulative character of an action or transaction.

150. Furthermore, the Commission will not require that a specific procedural forum be established solely for the enforcement of these rules. Rather, the Commission will act on any properly filed complaint under its existing complaint procedures. In addition, the Commission may act on information received via its Hotline procedures and establish investigations based upon such information if it finds sufficient substance to the allegations to warrant further investigation. As such, we will grant the requests for clarification submitted by Cinergy and Duke, regarding the applicability of these procedures to complainants' burden of proof obligations. In any complaint filed before the Commission, the complainant carries the burden of proof regarding the facts and law asserted, consistent with the Commission's existing complaint procedures.

151. We will deny the California Commission's request that we provide public procedures relating to Commission Staff's internal investigations. For the protection of all market participants, it is essential that the Commission's own internal investigations retain the degree of confidentiality currently embodied in our rules and policies.

152. We also decline to enumerate special rules applicable to summary judgment rulings or burden of proof determinations in complaint proceedings raising alleged Market Behavior Rule violations. In fact, the Commission's existing rules of practice and procedure will suffice in this regard. In addition, while we recognize Duke's concerns that complaints be processed on a timely basis, we decline to commit the Commission to a specified timetable in advance of our

consideration of the facts and circumstances that may be presented in a given case. Similarly, while EEI and EPSA raise concerns regarding the potential abuse of our hotline procedures, the Commission is fully capable of ferreting out such abuse on a case-by-case basis.

153. Finally, we decline to approve special complaint procedures applicable to governmental entities and/or non-market participants. In fact, we are satisfied that our complaint procedures and the Market Behavior Rules to which they apply will give all interested parties and the Commission itself a reasonable opportunity to monitor potential market abuses and, when appropriate, seek relief in the case of an alleged violation.

O. Section 206 Authority

The Market Behavior Rules Order found that the Commission is not barred by section 206 of the FPA from approving Market Behavior Rules applicable to market-based rate sellers, or allowing as a remedy the disgorgement of unjust profits. Specifically, the Market Behavior Rules Order rejected the arguments made by intervenors that the potential financial consequences for sellers found to be in violation of the Commission's Market Behavior Rules would violate the refund limitations set forth in section 206(b) of the FPA.[48]

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[48] Market Behavior Rules Order, 105 FERC ¶ 61,218 at PP 159-162. Section 206(b) requires that any refunds made in a section 206 proceeding initiated by the Commission on its own motion be based on a refund effective date no earlier than 60 days after the publication by the Commission of notice of its intent to

(*Footnote continued*)

1. Requests for Rehearing and Clarification

154. Cinergy, Duke, and Mirant and Williams argue that the Commission's disgorgement remedy violates section 206 of the FPA. Cinergy argues that the Commission has exceeded its authority under section 206 by setting forth overly-broad and unduly vague tariff conditions that, when and if applied in a future case against a particular seller, will impose on that seller the functional equivalent of a retroactive refund liability. Cinergy submits that use of the Commission's conditioning authority in this way, to apply in the future an amorphous standard that cannot be defined today, effectively writes the prospective limitations of section 206 out of the FPA. Cinergy argues that, in fact, section 206 provides a specific time frame under which past and final transactions cannot be unraveled. Duke agrees, asserting that the Commission's disgorgement remedy would, in effect, use the Commission's conditioning authority to set the filed rate for the first time on a retroactive basis, or do indirectly what the Commission may not do directly.

155. Cinergy further argues that by attempting to impose on sellers overly vague tariff conditions that can only by defined with particularity in the future, the Commission is effectively and unlawfully circumventing the burden of proof requirements of section 206. Cinergy notes that in a section 206 proceeding, the Commission (or in the case of a complaint proceed-

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initiate such a proceeding, or, in the case of a complaint, no earlier than 60 days after the complaint was filed. Section 206(b) also limits the refund effective period to five months after the expiration of such 60-day period.

ing, the complainant) bears the burden to prove that a rate charged under the tariff is unjust and unreasonable and that some new rate is just and reasonable.

156. Consumer Advocates and Cinergy also allege that the Commission has not satisfied its section 206 burden in this case by demonstrating that its Market Behavior Rules are just and reasonable. Cinergy asserts that this finding has not been made with respect to every market, every product, and every seller in the country. Consumer Advocates adds that the Market Behavior Rules Order, in adopting only guidelines regarding market participant conduct, fails to "fix" a particular rate as section 206 requires.

2. Commission Finding

157. We will deny the requests for rehearing seeking to nullify our Market Behavior Rules in their entirety based on the asserted requirements of section 206 of the FPA. In fact, section 206 of the FPA (and the section 206 procedures followed by the Commission in this proceeding), fully authorize and support our adoption of our Market Behavior Rules for all the reasons previously noted by the Commission in the Market Behavior Rule Order. As such, the rehearing requests on this issue, which raise many of these same arguments again, have already been addressed and rejected by the Commission.

158. Specifically, in the Market Behavior Rules Order, we explained in detail that our Market Behavior Rules would operate as a set of conditions, on a going-forward basis, to sellers' grant of market-based rates authority and that the Commission, in adopting these conditions, has broad authority to ensure that the rates subject to our jurisdiction are within a zone of reasonableness. For these same reasons, we also held

that the adoption of our Market Behavior Rules (and their future enforcement in a given case) would not violate the filed rate doctrine. The "filed rate," in this case, will be the behavioral standards voluntarily incorporated into the seller's tariff as an agreed condition relating to its grant of market-based rate authority.

159. In the Market Behavior Rules Order, moreover, we also addressed and rejected the argument that our disgorgement remedy would violate the refund limitations set forth in section 206(b) of the FPA. Specifically, we noted that we had initiated this proceeding under section 206 for the purpose of examining whether sellers' market-based rate tariffs are just and reasonable, or whether, conversely, they should be revised as we had proposed. Because we found that sellers' currently effective tariffs are unjust and unreasonable, or may lead to unjust and unreasonable rates without the inclusion of our proposed Market Behavior Rules, we were acting within our statutory authority when we further concluded that these tariffs should and must be revised. In ordering these revisions, moreover, we did so on a prospective basis, as section 206 requires.

160. We also noted that the Commission has the authority to impose the appropriate remedy where it finds that a violation of a Commission-approved rule has occurred. As such, we rejected the argument that a violation of an existing condition of service, e.g., one of our Market Behavior Rules, could not be remedied by the Commission from the time the violation was found to have occurred. We noted that the courts have upheld our authority in this regard in the fully

analogous context presented by the Natural Gas Act (NGA).[49]

161. We also clarified that our Market Behavior Rules Order was based on our findings of fact and the record evidence presented in this proceeding supporting our finding that sellers' existing tariffs are unjust and unreasonable under section 206. We noted that in any proceeding brought to enforce our Market Behavior Rules, the issue would be whether the seller at issue has violated its tariff. We found that, as such, the seller would have sufficient notice of the conditions required for service at the time of the implementation of the service conditions and that the Commission would be entitled, at its discretion, to fashion an appropriate remedy. For all these reasons, we decline to modify or rescind, on rehearing, our determination in the Market Behavior Rules Order that our Market Behavior Rules have been adopted and designed consistent with the requirements of section 206.

P. Coordination of Enforcement Responsibilities as Between the Commission and a Commission-Approved Market Monitoring Unit

The Market Behavior Rules Order provided guidance concerning the application and enforcement of the Commission's Market Behavior Rules relative to ISO/RTO rules. The Commission found that it was appropriate to authorize Market Monitoring Units (MMUs) to enforce certain

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[49] See Consolidated Gas Transmission Corp., et al., 771 F.2d 1536 (D.C. Cir. 1985) (holding that the Commission has the authority under section 16 of the NGA to order retroactive refunds to enforce conditions in certificates).

ISO/RTO tariff matters if those matters are: (i) expressly set forth in the tariff; (ii) involve objectively-identifiable behavior; and (iii) do not subject the seller to sanctions or other consequences other than those expressly approved by the Commission and set forth in the tariff. The Commission held that beyond this defined MMU authority, sellers' behavior will be subject to direct Commission enforcement in the first instance, regardless of whether the behavior occurs in ISO/RTO administered markets or bilateral markets.[50]

1. Requests for Rehearing and Clarification

162. TDU Systems and APPA and TAPS object to the Commission's determination that where an MMU finds a specific behavior not to be in violation of the applicable ISO/RTO tariff (and this determination is not appealed to the Commission), the seller will not be exposed, thereafter, to a subsequent Commission enforcement action involving the same matter. TDU Systems and APPA and TAPS charge that this enforcement limitation will handicap the ability of market participants to bring enforcement actions that may come to their attention and may also prohibit the Commission from carrying out its own enforcement responsibilities. APPA and TAPS further point out that in most cases, an aggrieved party may not even be aware that the MMU has rendered a determination regarding a particular seller. APPA and TAPS argue that, at a minimum, if MMU decisions will be preclu-

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[50] Market Behavior Rules Order, 105 FERC ¶ 61,218 at PP 180-186.

sive, then like Commission staff decisions, there should be public notice so that market participants have an opportunity to decide whether to take an appeal to the Commission.

163. APPA and TAPS also assert as error the Commission's failure to require market-based rate sellers to subject themselves to the authority of regional market monitors, especially in regions without organized ISO/RTO markets. APPA and TAPS argue that the Commission's ability to enforce its Market Behavior Rules will be seriously compromised in the non-ISO/RTO markets if it does not require regional market monitors.

164. Finally, Cinergy argues that the delegation of authority granted by the Commission to MMUs, including adjudicatory penalty authority, is improper and that such a delegation infringes on a seller's administrative due process rights. Cinergy argues that the Commission should not assign to MMUs any authority to render conclusions about market participant conduct.

2. **Commission Ruling**

165. We will deny rehearing of the Market Behavior Rules Order concerning RTO/ISO coordination issues and market monitoring matters. In the Market Behavior Rules Order, we clarified the respective duties and functions of the Commission and the MMUs, particularly with respect to initial actions regarding certain tariff violations. Specifically, we found that MMUs may administer compliance with certain tariff provisions where it is: expressly set forth in the tariff; the tariff provision involves objectively-identifiable behavior; and the MMU does not subject the seller to sanctions or other consequences other that those ex-

pressly approved by the Commission and set forth in the applicable tariff, subject to the right of appeal to the Commission. We further noted that if the MMU action was not appealed, or the MMU chose not to take action, the seller would not be exposed to subsequent Commission action with respect to the conduct at issue. In discussing the role of MMUs, we also referred to our MMU Communications Order, in which we stated that MMUs "are practically an extension, or a surrogate for, the Commission's own monitoring and investigative staff."[51] While we have used such language to characterize the role of the MMUs in the past, we clarify here that MMU personnel are not a substitute for Commission enforcement Staff. They are RTO employees or contractors, not Commission Staff. The ability of MMUs to take actions with respect to certain tariff compliance matters is akin to tariff compliance administered by personnel of other types of public utilities or jurisdictional gas pipelines (for example, Commission-approved tariffs may authorize a pipeline or public utility to issue operational flow orders). Unlike other public utilities, however, MMUs have a unique dimension to the scope of their activities since they are a key component of the market monitoring plans that the Commission has required RTOs/ISOs to develop and implement. We expect the conduct of the RTO/ISO market monitoring function to be such that the Commission and its staff can be informed by the information obtained by the MMU so that the Commission can take the appropriate action under the FPA.

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[51] See Communications with Commission-Approved Market Monitors, 102 FERC ¶ 61,041 at 61,091 (MMU Communications Order), order denying reh'g, 103 FERC ¶ 61,151 (2003).

166. Because the tariff compliance administered by the MMU pertains only to matters that are: (i) expressly set forth in the tariff; (ii) involve objectively-identifiable behavior; and (iii) do not subject the seller to sanctions or other consequences other than those expressly approved by the Commission and set forth in the tariff, the actions taken by the MMU, in this context, will not be based on an unauthorized grant of authority or involve the exercise of subjective judgments. Thus, in accordance with these guidelines, we confirm that actions taken by the MMU will not be subject to our further review, absent the filing of an appeal or a complaint. In addition, similar to the Commission's own practice with respect to preliminary investigations, we will not require the MMU to issue a "no action" notice confirming its determination to close out an investigation that it may have begun (but not pursued) against any given seller.

167. We also decline to use this proceeding as a vehicle to create MMUs for regions that do not have organized markets. Our clarifications regarding market monitoring matters, in the Market Behavior Rules Order, were intended to address how existing and future MMUs in organized markets would interface with the Commission in the context of our Market Behavior Rules. These clarifications were not intended to establish market monitors for non-RTO/ISO regions. As such, we deny the rehearing requests of APPA and TAPS proposing that such monitors be established. In fact, our Market Behavior Rules and the procedures we have adopted with respect to their enforcement represent a significant step forward in assuring that wholesale electricity rates are and will remain just and reasonable in both RTO/ISO markets as well as RTO/ISO markets.

168. The issues raised in this proceeding have caused us to further consider the appropriate role and structure of MMUs. As such, we have begun reviewing the various tariff provisions concerning MMUs in RTO and ISO markets. Accordingly, while we have included preliminary guidance in this proceeding regarding the role of the MMU and its relationship to the Commission, we are in the process of a thorough evaluation of this issue. We expect our review to lead to a Policy Statement through which we will clarify and rationalize the MMU's role across RTOs and ISOs and in relationship to the Commission.

169. Finally, we disagree with Cinergy that giving the MMU the responsibility to make decisions in the first instance with respect to certain tariff violations is a violation of a seller's due process rights. No MMU sanction can be imposed except as permitted by the terms of a Commission-approved tariff. Moreover, any MMU sanction in such matters is appealable to the Commission and only the Commission can ultimately act with respect to any contested sanction. Due process will be provided both before the MMU and in any appeal to the Commission.

The Commission orders:

(A) The requests for rehearing of the Market Behavior Rules Order are hereby rejected, as discussed in the body of this order.

(B) The requests for clarification of the Market Behavior Rules Order are hereby granted, in part, and denied in part, as discussed in the body of this order.

By the Commission. Commissioner Brownell concurring with a separate statement attached.

Commissioner Kelly concurring in part and dissenting in part with a separate statement attached.

(S E A L)

Linda Mitry
Acting Secretary

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations — Docket No. EL01-118-003

(Issued May 19, 2004)

Nora Mead BROWNELL, Commissioner *concurring*:

1. Market Behavior Rules 2(b), 2(c), and 3 provide that if the seller can establish that it exercised due diligence to prevent a violation, it will not be held liable. The order appropriately rejects requests to provide specific guidance on the application of this due diligence defense. There is a wide range of factors relevant to establishing whether a seller has exercised due diligence in a particular case-the existence of procedures designed to prevent violations, the history of seller's enforcement of such procedures, and the pervasiveness of the violations, to name a few. Therefore, the development of precedent on this issue is best left to case-by-case adjudication. I am writing separately, however, to clarify my interpretation of one portion of the order.

2. Paragraph 67 of the order justifies the inclusion of the due diligence defense on the ground that it provides a seller with the opportunity to present evidence relevant to the issue of intent. Paragraph 67 then notes that the existence of procedures designed to ensure accurate reporting would support a conclusion that any false submission was inadvertent and, thus, not a violation. I agree with this statement, but wish to make clear that it is only one example of the appli-

cation of the due diligence defense. As the order notes, intent is a necessary element of any violation of Market Behavior Rule 2(b), 2(c), or 3. Moreover, it is the seller's intent that ultimately concerns us under these Rules, rather than the intent of individual staff. Therefore, I do not intend to hold a duly diligent seller liable for the intentional actions of a rogue trader. Paragraph 68 states that the due diligence standard is not intended to bar the consideration of evidence that an individual trader personally knew the submitted information was false. I agree that a complainant should be allowed to introduce evidence that an individual trader acted with intent in order to establish a prima facie case. However, the seller who then establishes that it exercised due diligence to prevent such actions should be absolved of liability, and the state of mind of the individual trader should be irrelevant to the question of whether the seller did exercise due diligence.

Nora Mead Brownell

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Investigation of Terms and Conditions of Public Utility Market-Based Rate Authorizations — Docket No. EL01-118-003

(Issued May 19, 2004)

KELLY, Commissioner, concurring and dissenting in part:

I strongly support the Commission's effort to adopt clearly-defined "rules of the road" in sellers' market-based rate tariffs and authorizations that specify anticompetitive behavior or other market abuses, and set out remedies for such market abuses. I am writing separately because I concur on the issue of the remedies outlined in this order and I dissent regarding the statement in P 45 of this order that violations of the Market Behavior Rules could not be used "to support or justify the abrogation of a contract, unless the rule violation at issue has a direct nexus to contract formation and thus tainted the contract itself."

Remedy

This order appropriately upholds the determination in the Market Behavior Rules Order that a seller violating these rules would be subject to remedies, which include disgorgement of unjust profits, suspension or revocation of the seller's authority to sell at market-based rates or other appropriate non-monetary remedies. However, I do not believe that the Commission should exclude a make-the-market-whole

remedy as a possible monetary remedy for violations of the Market Behavior Rules.[1]

Contract Reformation or Abrogation

I dissent from this order to the extent that it provides that any party seeking contract reformation or abrogation under FPA section 206 based on a violation of one or more of the Market Behavior Rules is limited to those circumstances where the violation has a direct nexus to contract formation and has tainted the contract formation itself. I believe that imposing such a restriction on the circumstances that may give rise to a contract reformation or abrogation complaint, or the evidence that may be presented within the context of such a complaint, is inconsistent with FPA section 206. I believe such an *ex ante* restriction is unwarranted because the Commission should evaluate each complaint on an individual basis and consider all of the specific circumstances presented in each complaint.

For example, a seller may enter, in good faith, into a contract that bases the contract price on an electricity price index. At some point after the formation of that contract, the seller may engage in wash trades, a *per se* violation of Market Behavior Rule 2(a), in order to manipulate the electricity index price. The Commission should allow that evidence to be presented as part of a contract reformation or abrogation proceeding under FPA section 206, even though the rule viola-

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[1] The Commission accepted a make-the-market-whole remedy in a settlement with Reliant regarding physical withholding from the California PX market. See Fact-Finding Investigation Into Possible Manipulation of Electric and Natural Gas Prices, 102 FERC ¶ 61,108 (2003).

tion does not have a direct nexus to the formation of the contract.

For these reasons, I concur and dissent in part on today's order.

..... Suedeen G. Kelly